

Santa Fe Pacific Realty Corporation

201 Mission Street, Suite 250
San Francisco, California 94105
415/974-4585

SFUND RECORDS CTR
88090882

SFUND RECORDS CTR
1633-00873

May 10, 1988

Mr. Jeff Zelikson
Director
Toxics and Waste Management Division
United States Environmental Protection Agency
Region IX
215 Fremont Street
San Francisco, CA 94108

Attention: Ms. Jennifer Decker
Remedial Project Manager

Re: Coalinga Asbestos Company (T-4-3)

Dear Mr. Zelikson:

This letter is submitted by Santa Fe Pacific Realty Corporation ("SFPRC"), a wholly-owned subsidiary of Santa Fe Southern Pacific Corporation ("Santa Fe"), in response to your March 18, 1988 letter to Mr. Ted Fitzpatrick, SFPRC, 250 S. Rock Boulevard, Suite 100, Reno, Nevada 89502 ("the March 18 letter"). The March 18 letter, which was received by SFPRC on April 6, 1988, requests SFPRC to furnish certain information to the U.S. Environmental Protection Agency ("EPA") pursuant to EPA's authority under Section 104 of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA"). On May 6, 1988, Ms. Jennifer Decker provided SFPRC with an extension until May 11, 1988, to submit its responses to the March 18 letter.

The March 18 letter seeks information which may be relevant to EPA's investigation of potential hazardous conditions at several properties located in the City of Coalinga, California, at 1075 W. Elm Avenue, 1175 W. Elm Avenue, and 210 W. Glenn Avenue (collectively the "City of Coalinga properties"), at the "Coalinga Asbestos warehouse" located at 505 W. Elm Avenue, and at a 30-40 acre site located approximately 17 miles northwest of Coalinga used for mining and milling operations (the "Coalinga mill site"). Despite the fact that they are widely distributed geographically, the letter refers to these properties collectively as the "Coalinga Asbestos Company site" or simply the "site". No explanation is given as to why the properties are grouped together in this fashion.

None of the properties referred to in the March 18 letter are owned by SFPRC. It is SFPRC's understanding that EPA already may be dealing with the Southern Pacific Transportation Company ("Southern Pacific") as the owner of the City of Coalinga properties and the Coalinga Asbestos warehouse property. While Southern Pacific is a wholly-owned subsidiary of Santa Fe, Santa Fe's ownership of Southern Pacific is subject to the terms of an independent voting trust designed to ensure that Southern Pacific's management and operations are conducted separate and apart from Santa Fe and its other subsidiaries, including SFPRC. Moreover, pursuant to a February 24, 1987 order of the U. S.

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Interstate Commerce Commission (ICC Decision, Finance Docket 30400), Southern Pacific is operated as a completely independent business unit, and any communications with Santa Fe and its subsidiaries (including SFPRC) are strictly limited. As a result, SFPRC maintains no files or other information with respect to Southern Pacific properties, including any of the Southern Pacific properties that are the subject of EPA's March 18 letter.

The Coalinga mill site is located within a larger tract of approximately 557 acres owned by the Southern Pacific Land Company ("SPLC"). This 557-acre tract currently is the subject of a remedial investigation and feasibility study ("RI/FS") being conducted by SPLC in accordance with an administrative order on consent (the "Consent Order") executed by SPLC and EPA on November 16, 1987 pursuant to EPA's authority under Section 106 of CERCLA. SFPRC does not presently own or operate the SPLC property containing the Coalinga mill site or any facility located on the SPLC property, nor has it owned or operated that property or any such facility in the past. SPLC is a separately incorporated, wholly-owned subsidiary of Santa Fe. SPLC's real property holdings are managed by SFPRC, however which acts as SPLC's agent for that purpose.

Because the City of Coalinga properties, the Coalinga Asbestos warehouse property and the Coalinga asbestos mill site are widely separated geographically, because they are owned by different corporate entities that are legally and operationally distinct, and because the Coalinga mill site already is the subject of EPA action under CERCLA that expressly does not encompass the City of Coalinga properties and the Coalinga Asbestos warehouse property, SFPRC believes it is inappropriate to relate these properties together as a single "site" for purposes of responding to the information requests contained in EPA's March 18 letter. SFPRC therefore objects to any requirement to respond to the information requests contained in the letter on that basis.

Nevertheless, SFPRC wishes to cooperate as fully as reasonably possible with EPA's investigation of possible hazardous conditions at the various properties addressed by the March 18 letter. SFPRC has made a good faith search for information it believes to be relevant and responsive to EPA's requests and to be within the scope of CERCLA Section 104. On that basis, SFPRC provides the following responses to EPA's specific requests. SFPRC notes that the only property listed in the March 18 letter for which SFPRC has information is the SPLC property which is subject to the Consent Order.

Request No. 1

Date of purchase of your property and who the property was purchased from.

Legal description of property boundaries and title maps indicating boundaries. Please respond and provide documentation supporting your response.

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Response to Request No. 1

SFPRC objects to Request No. 1 on the grounds that it is vague, ambiguous, overly broad and that it calls for information not relevant to the matters for which EPA has authority to request information pursuant to CERCLA Section 104. Subject to these objections, SFPRC responds to Request No. 1 as follows.

As explained above, SFPRC does not presently own or operate, nor has it previously owned or operated any of the properties that are the subject of this request or other requests contained in the March 18 letter. Moreover, SFPRC has no information concerning the purchase of the City of Coalinga properties.

As further explained above, the Coalinga mill site is part of a 557-acre tract owned by SPLC. This 557 acre tract comprises the entirety of Section 1, Township 19 South, Range 13 East, on the U.S. Geological Survey 7-1/2 Minute Santa Rita Peak Quadrangle Map. The section is one of the alternate sections granted to Southern Pacific by the United States government pursuant to the Act of Congress of July 27, 1866 (14 Stats. 292) Atlantic and Pacific Charter. Southern Pacific, its successors and assigns (including SPLC) have owned the section continuously since the original grant. An assessor's parcel indicating the section is attached as Attachment A to this letter.

Request No. 2

Have you had any buildings taken down which existed on the property when it was purchased?

Response to Request No. 2

SFPRC objects to Request No. 2 on the grounds that it is vague, ambiguous and overly broad, and that it calls for information not relevant to the matters for which EPA has authority to request information pursuant to CERCLA Section 104. Subject to these objections, SFPRC responds to Request No. 2 as follows.

SFPRC has not had any buildings taken down on any of the properties that are the subject of this request.

Request No. 3

Have you made any improvements to the property since purchase, such as construction, grading and/or import of fill material? Please provide documentation supporting your response for each improvement.

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Response to Request No. 3

SFPRC objects to Request No. 3 on the grounds that it is vague, ambiguous and overly broad. SFPRC further objects to Request No. 3 insofar as it calls for information not relevant to the matters for which EPA has authority to request information pursuant to CERCLA Section 104. Subject to these objections, SFPRC responds to Request No. 3 as follows.

SFPRC has not made any improvements to any of the properties that are the subject of this request. It is SFPRC's understanding that during 1986, SPLC reconstructed an existing earthen dam located on SPLC's property immediately below the Coalinga mill site and designed to trap sediment contained in an intermittent stream (the eastern fork of Pine Canyon Creek) that runs through the property. In connection with the dam reconstruction operation, which was performed with the approval of EPA, SPLC also restored and graded an unpaved road in order to reach the location of the dam.

Request No. 4

What area(s) were used to store and load materials onto trucks:

- Procedures used to load material onto trucks.
- How material was packaged.

Response to Request No. 4

SFPRC objects to Request No. 4 on the grounds that it is vague and ambiguous and overly broad. Among other things, the term "material" as used in this request is undefined and confusing. For purposes of this response, and the responses to Requests Nos. 5, 6 and 7, SFPRC assumes, unless otherwise noted, that the term refers to "asbestos", which is the principal material of concern to EPA. SFPRC further objects to Request No. 4 on the grounds that it calls for information not relevant to the matters for which EPA has authority to request information pursuant to CERCLA Section 104. Subject to these objections, SFPRC responds to Request No. 4 as follows.

SFPRC has not used any area or areas at any of the properties that are the subject of this request to store and load materials of any kind onto trucks. SFPRC understands that past tenants and others may have loaded asbestos onto trucks, but lacks information about what areas may have been used to store and load such asbestos, or any other materials, onto trucks, if any.

Request No. 5

What type(s) of trucks were used to transport material.

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- Were trucks covered as a normal procedure? Please describe transport procedures.

Response to Request No. 5

SFPRC objects to Request No. 5 on the grounds that it is vague, ambiguous and overly broad. SFPRC further objects to Request No. 5 on the grounds that it calls for information not relevant to the matters for which EPA has authority to request information pursuant to CERCLA Section 104. Subject to these objections, SFPRC responds to Request No. 5 as follows.

SFPRC has not transported "materials" from any of the properties that are the subject of this request, by truck or otherwise. SFPRC understands that past tenants and others may have transported milled asbestos from the Coalinga mill site. However, SFPRC lacks information about what trucking or transport procedures were used for this purpose.

Request No. 6

Did spills, leaks or accidents occur? If so, how was material cleaned up and where did these releases occur? Please describe detailed description (sic) of the releases and clean up procedures.

Response to Request No. 6

SFPRC objects to Request No. 6 on the grounds that it is vague, ambiguous and overly broad. Subject to these objections, SFPRC responds to Request No. 6 as follows.

SFPRC has not spilled or leaked asbestos at any of the properties that are the subject of this request. SFPRC understands that asbestos wastes are present at the Coalinga mill site because of operations conducted at the site by others. As explained above, in accordance with the terms, requirements, and scope of the Consent Order, SPLC is performing an RI/FS to assess the nature and extent of releases or threats of releases, if any, of hazardous substances at that site. However, SFPRC lacks information about whether any hazardous substances are present at the site as a result of any "spills, leaks or accidents."

Request No. 7

Are records of transporting material from the Atlas Asbestos Company and Coalinga Asbestos Company available? If so, give the location, address, contact name and phone number of where these records are located.

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Response to Request No. 7

SFPRC objects to Request No. 7 on the grounds that it is vague, ambiguous, and overly broad. Subject to these objections, SFPRC responds to Request No. 7 as follows.

There are no records of transporting material from the Atlas Asbestos Company and Coalinga Asbestos Company within the possession, custody or control of SFPRC.

Request No. 8

A descriptive list of all insurance policies held by your company. The description should include the dates during which each policy was in force, the general type of policy (e.g., comprehensive, general liability, automobile) and the insurance company issuing the policy, policy number, and any specific provision of the policy which may relate to claims for environmental damages. For each insurance company include the address, contact name and phone number.

Response to Request No. 8

SFPRC objects to Request No. 8 on the grounds that it is overly broad and calls for information not relevant to the matters for which EPA has authority to request information pursuant to CERCLA Section 104. Subject to these objections, SFPRC responds to Request No. 8 as follows.

A certificate of insurance providing relevant information responsive to Request No. 8 is attached to this letter as Attachment B.

Request No. 9

An audited set of financial statements which includes a Statement of Financial Position/Balance Sheet, Income Statement, Statement of Changes in Working Capital, and any other supplementary information for your company's most recent fiscal year.

Response to Request No. 9

SFPRC objects to Request No. 9 on the grounds that it calls for information not relevant to the matters for which EPA has authority to request information pursuant to CERCLA Section 104. Subject to this objection, SFPRC responds to Request No. 9 as follows.

A set of audited financial statements separate from those prepared for its parent company, Santa Fe, is not available for SFPRC. An audited set of Santa

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Fe's financial statements for its most recent fiscal year is attached to this letter as Attachment C.

* * *

The responses contained in this letter are to the best of SFERC's information and belief. No other representation is made with respect to the truth or accuracy of these responses. While SFERC has conducted a diligent search for relevant and responsive information in its possession, custody or control, SFERC cannot and does not make any representation that the information provided is in fact responsive to EPA's requests as that term may be interpreted by EPA. Furthermore, SFERC's responses are made on the basis of such information as is currently known and reasonably available to SFERC within the thirty day period allowed by EPA for SFERC to provide its responses. SFERC reserves the right to change, supplement or withdraw its responses if deemed appropriate in light of information developed as a result of further investigation and inquiry.

Finally, information contained in Attachment B to this letter constitutes confidential business information within the meaning of 40 C.F.R. Part 2, Subpart B. This confidential information, which is being submitted voluntarily to EPA at EPA's request, is not available and should not be made available by EPA to any person or persons without SFERC's express prior written consent. SFERC understands that EPA, pursuant to 40 C.F.R. § 2.204(e), shall promptly notify SFERC in writing if disclosure of this confidential information is sought by any person or if EPA otherwise takes any action with respect to the disclosure of this information.

If you have any questions concerning the information contained in this letter or otherwise with respect to the subject matter of your March 18 letter, please contact either Edward L. Strohbehn, Jr., Esq., or Kevin T. Haroff, Esq., of McCutchen, Doyle, Brown & Enersen, Three Embarcadero Center, San Francisco, California, 94111 (telephone: 415/393-2000).

Very truly yours,
Santa Fe Pacific Realty Corporation

By 
T. C. Sager
Property Manager
Property Management Services

Attachments

TCS/mm
1614M

NOTE ---
 Assessment purposes only
 shown as portraying
 divisions of land for
 or subdivision law

SEC'S. 1, 2, 3, 10, 11, & 12, T. 19S., R. 13E. M.D.B. & M.

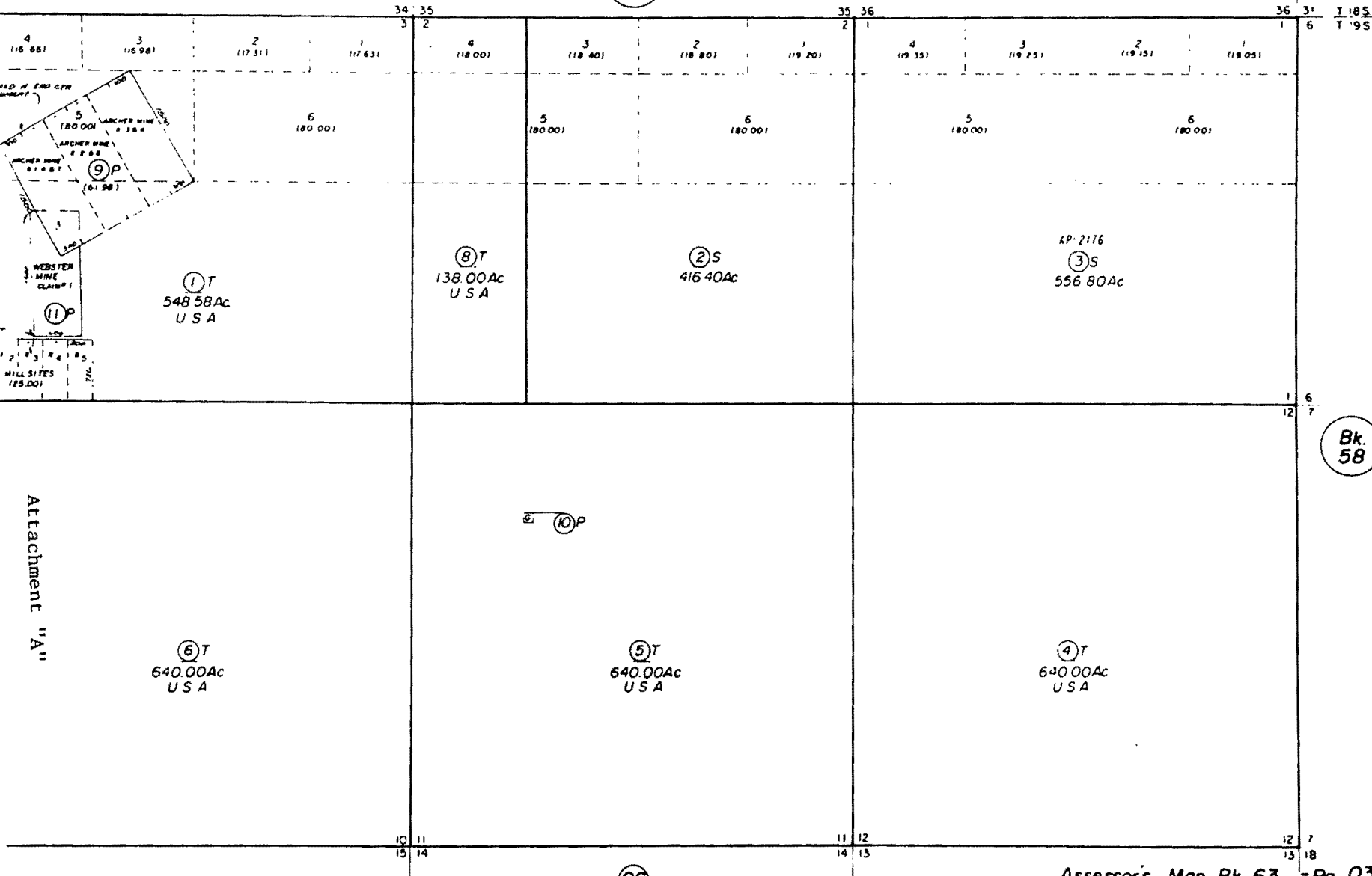
Tax Rate Area
 77 001

63-03

Bk.
 45

1/2
 1/4
 1/8

1" = 100'



Attachment "A"

Agricultural Preserve

Assessor's Map Bk. 63 -Pg. 03
 County of Fresno, Calif.

NOTE - Assessor's Block Numbers Shown in Ellipses.
 Assessor's Parcel Numbers Shown in Circles





INSURANCE CERTIFICATE

This is to certify that the policy or policies listed below have been issued to the named insured and are in force as of the date of this certificate. This Certificate shall remain in effect until the listed expiration date, if any, or until 30 days after written notice is mailed to the certificate holder, whichever date shall first occur.

30

This certificate is not an insurance policy and does not amend, alter or extend coverage afforded by the policies listed. Notwithstanding any requirement, term or condition of any contract or other document with respect to which this certificate may be issued or may pertain, the insurance afforded by the policies listed is subject to all the terms of such policies.

NAME AND ADDRESS OF CERTIFICATE HOLDER

EFFECTIVE DATE OF THIS CERTIFICATE

January 1, 1987

ISSUED AT

Dallas, TX

TEXAS EMPLOYERS'
INSURANCE ASSOCIATION

TEXAS EMPLOYERS
INDEMNITY COMPANY

EMPLOYERS CASUALTY
COMPANY

EMPLOYERS NATIONAL
INSURANCE COMPANY

EMPLOYERS CASUALTY
CORPORATION

EMPLOYERS NATIONAL
INSURANCE CORPORATION

EMPLOYERS OF TEXAS

LLOYD'S

BY (Authorized Representative)

(Signed)

(Typed) Don Burkley, Sr. Ex. Rep. NAJ

NAME AND ADDRESS OF INSURED

Santa Fe Southern Pacific Corporation &/or

Santa Fe Pacific Realty Corporation

224 S. Michigan Avenue
Chicago, IL 60604

INSURANCE IN FORCE		Expiration Date	LIMITS OF LIABILITY NOT LESS THAN			STATE AND LOCATION OF OPERATIONS
Kind	Policy Number		Each Person	Each Accident (or Occurrence) Per Policy Provisions	Per Policy Or Aggregate	
Item 1 Work Comp and Emp Lib.	Coverage A 79837	If Blank - See Heading	Fully Complies With Requirements of Texas Workers' Compensation Law			STATE OF TEXAS
	Coverage B And Renewal Thereof		XXX	1,000,000 \$100,000	Disease Only 1,000,000 \$100,000	
Item 2 Work Comp and Emp Lib.	Coverage A 565931	If Blank - See Heading	Fully Complies With Requirements of State Law			States other than Texas
	Coverage B 565932 877650 And Renewal Thereof		XXX	1,000,000 \$100,000	Disease Only 1,000,000 \$100,000	
Item 3 General Comp and Gen Lib.	Badly Injury 566278	If Blank - See Heading	\$ XXX	\$ 1,000,000	Products Only Single Limit	U.S.A., ITS TERRITORIES OR POSSESSIONS AND CANADA
	Property Damage And Renewal Thereof		XXX	\$	\$	
Item 4 Auto Public Liability	Badly Injury 597127, 597128 801863	If Blank - See Heading	\$ 1,000,000	\$ Combined	Not Applicable	U.S.A., ITS TERRITORIES OR POSSESSIONS AND CANADA
	Property Damage And Renewal Thereof		XXX	\$ Single Limit	Not Applicable	
Item 5			\$	\$	\$	
	And Renewal Thereof	If Blank - See Heading	\$	\$	\$	
Item 6			\$	\$	\$	
	And Renewal Thereof	If Blank - See Heading	\$	\$	\$	

REMARKS

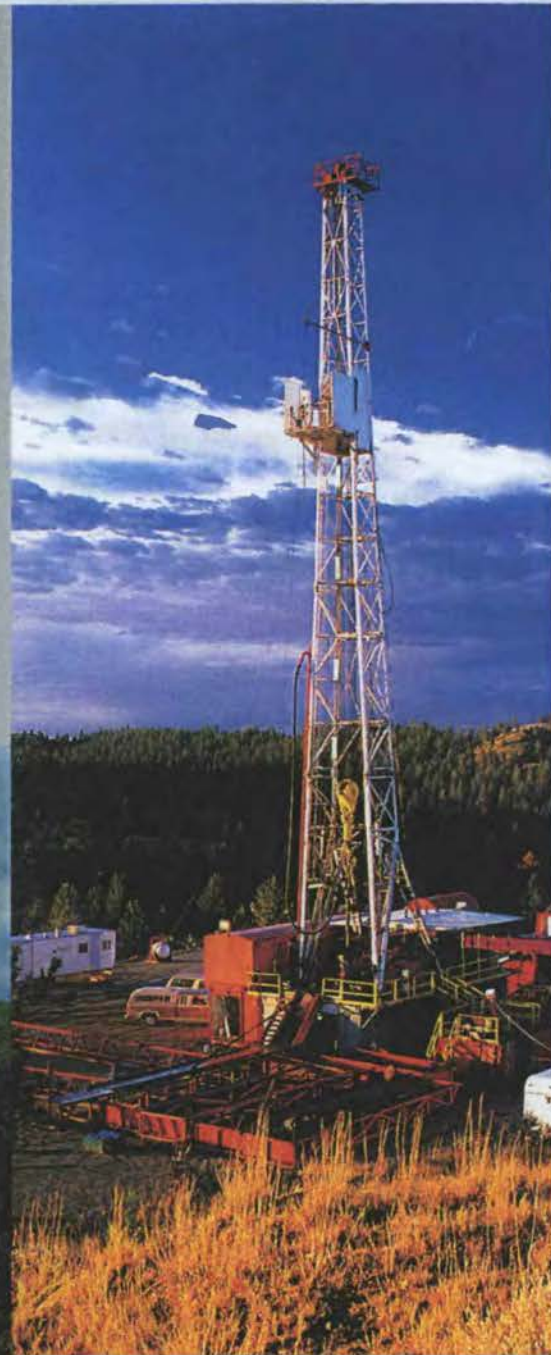
Contact: Kim Pleasant
(214) 760-3716

Attachment "B"

0873

**Santa Fe
Southern Pacific
Corporation**

**1987
Annual Report**



Corporate Profile

Santa Fe Southern Pacific Corporation's diversified operations are centered in three major business areas: transportation, real estate, and natural resources. The corporation was formed in 1983 as the parent company of Santa Fe Industries, Inc. and its affiliates, and Southern Pacific Company and its affiliates.

Transportation



Rail
Rail and pipeline systems provide the company with a broad base in transportation. The Atchison, Topeka and Santa Fe Railway, with approximately 11,700 route miles, stretches from Chicago south to the Gulf of Mexico at Houston and Galveston, and through the Southwest to the Pacific Coast ports of San Francisco, Los Angeles and San Diego.

Real Estate



Pipeline
Our 3,020-mile refined products system is the largest products pipeline system in the western United States. It transports gasoline, diesel and jet fuel in Oregon, California, Nevada, Arizona, Texas and New Mexico.



Real Estate
The company owns significant real estate in 15 states in the West, Southwest and Midwest. This property includes valuable tracts located in major cities, property suitable for commercial and industrial development, agricultural land, and outlying lands.

Natural Resources



Petroleum
Natural resources activities include petroleum and hard minerals exploration, development, production and marketing. Petroleum operations involve onshore oil and gas exploration and development, and participation in offshore joint ventures.



Hard Minerals
Ongoing income is derived from coal royalties and production. Shipments from our first coal mine began in 1984, and are expected to continue for several decades. The company has approximately 8 million acres of mineral rights in the Southwest. Silver production began in early 1988 and gold production is expected to begin later in the year.

Financial Highlights

Santa Fe Southern Pacific Corporation and Subsidiary Companies

	1987	1986	1985	1984	1983
	(In Millions)				
For The Year					
Revenues	\$ 5,448.4	\$ 5,314.4	\$ 5,947.8	\$ 6,190.6	\$ 5,547.2
Income (Loss) from Continuing Operations,					
Net of Income Tax	345.7	(285.3)	438.8	462.5	295.8
Capital Expenditures	1,153.7	1,061.4	1,078.3	1,111.6	958.3
Depreciation, Depletion and Amortization	539.4	674.5	569.1	551.7	542.0

	(In Millions)				
At Year End					
Total Assets	\$11,762.2	\$11,601.8	\$11,807.6	\$11,648.7	\$11,387.8
Working Capital (Deficit)	(319.5)	209.4	327.8	649.0	877.4
Long Term Debt	1,704.2	1,726.6	1,597.6	1,668.0	1,609.4
Stockholders' Equity	5,207.9	5,040.3	5,764.2	5,768.5	5,740.8

Per Common Share					
Net Income (Loss)					
Continuing Operations	\$ 2.19	\$ (1.73)	\$ 2.50	\$ 2.46	\$ 1.57
Discontinued Operations	.18	.89	.17	.15	2.36
Total	2.37	(.84)	2.67	2.61	3.93
Stockholders' Equity	33.39	32.11	33.97	32.20	30.20
Cash Dividends	1.00	1.00	1.00	1.00	NA

Note: Cash dividends per share is not applicable for periods prior to December 23, 1983, the date of the business combination.

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		33 Corporate Information

The year 1987 and the early months of 1988 constituted one of the most eventful and significant periods in the history of your company.

From the standpoint of financial results, 1987 was a very successful year. Our net income was \$373.5 million, or \$2.37 a share, compared with a net loss of \$137.9 million, or \$.84 a share for 1986. The 1986 results reflected significant charges for rail restructuring and impairments of oil and gas properties, as well as a gain from the sale of Kirby Forest Industries. Even when all these unusual items are removed, however, net income for 1987 was 22 percent better than in the previous year.

While the 1987 results demonstrate the basic strength of our core businesses, they do not represent the most significant development of the past year. You have already received correspondence outlining the major restructuring program initiated early in the year, but it is appropriate to discuss here the reasons for that program and what we anticipate as we look to the future.

As 1987 began, we were still pursuing the merger of our two railroads in a proceeding that had been in progress almost three years. We still believed such a merger would be in your best interests, as well as those of our rail customers, our employees, and the public at large. As time progressed, however, it began to look doubtful whether we would succeed in obtaining a favorable decision from the Interstate Commerce Commission to reconsider the case, which had been disapproved in October, 1986. We knew that if the railway merger could not be consummated, serious corporate decisions would have to be promptly made. Therefore, with the assistance of our investment bankers, we intensified studies commenced in 1986 that encompassed not just the future of our railroad operations, but a rational and deliberate examination of the entire company and each of its businesses. Our objective was to determine how we could create the most value for you from these assets from both the long and short-term viewpoint.

During this review, we considered what our individual businesses would bring "up front" if we concluded to sell them, compared with their value in terms of earnings and cash flow if they were retained. During the course of these studies, we had already made an advantageous sale of Kirby Forest Industries, described in last year's report. Our further review suggested that your interests would best be served if we concentrated on our core businesses of transportation, including both railroading and products pipelines; natural resources, including petroleum and hard minerals; and real estate.

While this general plan was being formulated in the spring of 1987 several significant events occurred. On April 19, Chairman John Schmidt submitted his resignation, following which the Board requested Director John S. Reed, who had retired in 1983 as



Robert D. Krebs
President and Chief Executive Officer

John S. Reed
Chairman

Chairman and Chief Executive Officer of Santa Fe Industries, to return temporarily as Chairman and CEO of the company. This was done to assure speed and continuity in carrying out our developing program at a most critical time. A further urgent need was the identification and selection of a permanent new CEO. After an extensive search both inside and outside the company, President Robert D. Krebs was elected President and CEO by the Board on July 28 and has guided the affairs of the company since that time.

The next significant event was the disappointing adverse decision of the ICC on June 30 when it declined our petition, filed in 1986, to reopen the railway merger case despite the conditions and accommodations which we had agreed to make.

These events led to the immediate public announcement and acceleration of our restructuring plans. Since then we have sold Robert E. McKee, Inc., our general building contractor; Santa Fe Pacific Timber Company; Bankers Leasing and Financial Corporation; and two of the smaller pipe line systems, the Gulf Central anhydrous ammonia line and the Chaparral natural gas liquids line. In compliance with the orders of the ICC, we filed a railway divestiture plan, electing to sell the Southern Pacific Transportation Company. Subsequently a contract has been executed with Rio Grande Industries for the sale of the SPT, subject to ICC approval, which it is hoped will be obtained prior to year-end.

We have retained those core businesses which comprise the best assets of the company, and which produced nearly three-fourths of our operating income last year. In making the railway divestiture decision, it was noted that the Santa Fe historically has been a better performing railroad and of the two has the best potential for future success due to

its superior routes between Chicago and California and between Chicago and the Gulf of Mexico. The Santa Fe also has a strong position in the inter-modal market, the fastest growing area of rail business.

In the pipeline area, we retained our petroleum products pipeline system, which has been experiencing demand that has outstripped capacity. We are embarking on an expansion this summer to meet that growing demand. In the natural resources area we retained Santa Fe Energy Company, the sixth largest independent petroleum company in the nation in terms of total reserves (including both oil and gas). Santa Fe Energy is first among the independents in proved oil reserves and production, and has significant probable reserves.

We have a firm foundation in the hard minerals area with our Lee Ranch coal mine, which has additional capacity and large reserves. Our precious minerals exploration efforts began to bear fruit in early 1988 as the first silver bullion was produced from a joint venture mine. We have also approved participation in a joint venture gold mine that should begin producing gold by the end of the year. Development of other prospects on our mineral lands is continuing.

In real estate we have changed our focus to realize values faster and will begin this year to reap the benefits of previous development efforts. Our inventory of real estate will allow us to sustain earnings and cash flow over the next five years as our debt is being repaid and still leave us with sizeable assets at the end of that period.

As we studied our company and completed the planning process, we did not deviate from our goal of creating a balance between long-term and short-term values. Retaining the assets described above should ensure long-term values for you. The special dividend which you recently received of \$25 in cash and \$5 principal amount senior subordinated 16 percent debenture represented short-term value for you. We elected to issue the PIK debenture with interest paid-in-kind for a portion of the dividend because that allowed us to increase the value you could receive now, without the requirement to pay cash interest in the early years. Even though the special dividend represented a large cash outlay and included the incurrence of considerable debt, we believe it was a prudent decision. A significant portion of our debt repayments will be made from the sale of assets, and we have already begun those payments.

We have the capability to develop the company's remaining core assets over time, even as the debt is being repaid. Over our five year planning horizon we anticipate spending, on average, in excess of \$500 million a year in capital expenditures, which we believe is sufficient to meet our growth expectations. While this restructuring and special dividend have caused us to reduce our regular dividends for

the present to 10c annually, the Board hopes to increase the dividend in future years as this growth occurs.

In our efforts to maximize values for you, the shareholder, we looked at other alternatives, including the possibility of selling the entire company. One large shareholder, The Henley Group, indicated an interest at one time in acquiring the company. We carried out protracted negotiations with them, but were never able to reach an agreement nor to receive a firm offer that we believed was acceptable.

We also discussed possible sale of the company with Olympia & York Developments, Ltd., another large shareholder. While they ultimately decided to remain an investor rather than seek ownership of the entire company, our relations with them have been very constructive. Olympia & York has considerable expertise in real estate and natural resources, two of our core businesses. We have named two of their representatives to our Board of Directors. We look forward to their counsel in these areas.

The new directors are: Mr. Paul Reichmann, Senior Executive Vice President of Olympia & York Developments, Limited, and Mr. Marshall Cohen, President of Olympia & York Enterprises Corporation.

The decisions made in recent months were major and momentous. Your Board realizes that we must constantly be alert for ways to improve values for you, the owners of the company, and we remain flexible and receptive to new opportunities that may arise. We look forward with confidence to the future.

Alan C. Furth, vice chairman of the Company and president of Southern Pacific Company retired from his positions with the Company and the Board of Directors during 1987. Mr. Furth served the Company as an employee since 1949 and as a director since 1972. In addition, Mr. Benjamin F. Biaggini, retired chairman and chief executive officer of Southern Pacific Company who has served as a director since 1963, and Mr. Arjay Miller, dean emeritus of the Graduate School of Business, Stanford University, who has served as a director since 1979, will retire from the Board of Directors effective with the 1988 annual meeting. Their valued counsel will be missed.

On behalf of the Directors, we wish to express appreciation to the officers and employees for their efforts and loyalty in a difficult period, and to our stockholders, customers and suppliers for their support.

March 15, 1988



John S. Reed
Chairman



Robert D. Krebs
President and
Chief Executive Officer



W. John Swartz

Vice Chairman

Santa Fe Southern Pacific
Corporation and
President

The Atchison, Topeka and
Santa Fe Railway Company

Santa Fe Railway enjoyed a good year in 1987 and reported operating income of \$176.8 million, compared with an operating loss of \$142.0 million last year. Without a special charge related to restructuring costs, 1986 operating income would have been \$170.8 million. Compared with that figure 1987 results were up four percent.

Our traffic showed a significant rebound from 1986, increasing over six percent. This trend accelerated during the second half, which showed a 10 percent increase. Volumes have also been good during the early days of 1988. Strong competition from other railroads and the deregulated trucking industry continues to exert pressure on prices, which resulted in our average revenue per carload in 1987 being down approximately five percent from the previous year.

Strategy

Our strategy for 1988 and beyond is to compete aggressively in transcontinental markets, concentrate on our core system routes, maintain our physical plant, and reduce our operating expenses. This report describes specific actions we have taken and will continue to take to implement that strategy.

Looking to 1988, there are two major challenges. The first is to hold and build upon traffic gains enjoyed in 1987 in what appears likely to be an uncertain economy. The second challenge is to reach a labor agreement that will enhance productivity so that we can improve profitability in the current competitive environment. These two challenges are closely related, for success in improving efficiency will enhance our ability to offer competitive prices and maintain our traffic base.

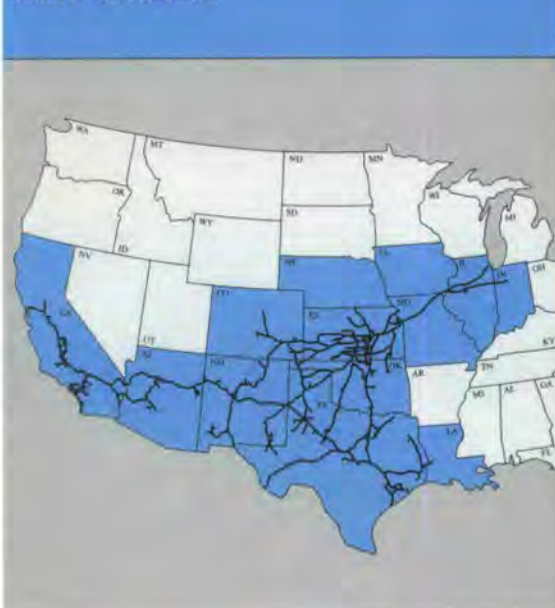
It is equally vital that the industry not be saddled with re-regulation. Groups with narrow interests are supporting legislation which would negate many freedoms railroads have gained to price services. Shippers have joined the railroad industry in resisting such legislation. Those efforts have been successful so far, but the issue is not yet resolved.

There are other problems unique to the railroad industry which should be addressed. Unlike other major industries, railroads are subject to secondary boycotts, and employee injuries are handled on an adversarial basis, rather than under a Worker's Compensation System. We have joined efforts to generate legislation addressing these issues.

Marketing and Sales

Our major increases in volume during 1987 came from grain and intermodal shipments. Grain carloadings were up nearly 33 percent from the previous year, primarily reflecting increased exports and domestic marketing programs. The export increase is due in part to the export enhancement program under which subsidies are provided to make American grain more competitive in world markets. The weaker dollar will also make American grain more compet-

Santa Fe Rail Network



Rail Data Santa Fe

	1987	1986	1985
Operating income (millions)	\$176.8	\$170.8	\$145.5
Capital expenditures (millions)	\$283.8	\$300.2	\$397.6
Carloads handled (thousands)	1,434	1,350	1,398
Operating ratio	90.6%	90.8%(1)	92.8%
Revenue ton-miles (billions)	72.0	67.1	69.1
Average haul per ton (miles)	749	737	726
Track miles of rail laid	486	480	618
Ties inserted (thousands)	1,672	1,775	1,804
Freight cars	41,637	43,821	47,569
Locomotives	1,704	1,774	1,822
Trailers	3,006	4,984	7,202

(1) Before restructuring costs

Revenue Ton-Miles by Principal Commodity*

	1987	1986	1985
Grain	9,804	7,218	6,542
Food and Farm Products	13,095	11,748	10,791
Chemicals	7,373	6,753	6,633
Coal	6,973	7,459	9,021
Metal Products	1,939	1,701	1,609
Petroleum Products	1,901	1,841	1,930
Non-Metallic Minerals	2,321	2,726	3,235
Paper Products	1,858	1,845	1,791
Lumber, Plywood and Logs	1,248	1,241	1,104
Vehicles and Parts	2,151	2,297	2,298
Merchandise	12,351	11,319	13,020
Other	3,806	3,369	3,269
Total	64,820	59,517	61,243
TOFC/COFC ton-miles included in the above	20,955	19,332	20,006

*The data shown above are calculated based on the annual freight commodity statistics furnished to the Interstate Commerce Commission, but the total revenue ton-miles are less than reported in the table above and SEC Form 10-K, as a result of the method of accumulating the data.

itive. Heavy grain shipments have continued into the early part of 1988. It is unclear whether this growth will continue throughout the year, but we do anticipate a good year in grain.

Intermodal shipments increased 13.4 percent over 1986, totaling nearly 800,000 trailers and containers. The number of trailers handled increased 14.5 percent and container shipments were up 10.9 percent. We are competing aggressively for business in markets we have not served traditionally. One of those markets is "short-haul" traffic where motor carriers are dominant. In late 1986 we established a "Quality Service Network" to compete for this traffic. Crews on these trains operate over greater distances than conventional trains, enhancing our ability to compete from a service and price standpoint. Traffic from our entire system flows into this network, which encompasses a geographic area bounded by Kansas City, Houston, Denver and Phoenix. Our market share for short haul business in these corridors was below one percent when the QSN network was started, and has grown to approximately five percent. In 1987 we handled approximately 55,000 trailers and containers on QSN trains, all new business. We expect that volume to increase in 1988.

We also expect continued growth in 1988 from our Intermodal Market Extension (IMX), which was expanded in 1987 to include Sacramento, California and four cities east of Chicago. Under this concept trucking firms provide a fast link between the IMX terminals and the railway system. Customers drop off or pick up trailers or containers at the IMX terminals and are provided with a single rate and service direct to final destination.

We continue to attract new business from long-haul trucking firms which deal directly with shippers, provide pick-up and delivery service, but rely on the railroad for the long haul. New contracts were signed for handling ocean-going containers stacked two high on rail cars, and we plan to compete aggressively for additional double stack traffic in 1988.

More than 80 percent of our revenues now comes from traffic that moves under contract or is exempt from regulation entirely. For this latter traffic rates can be quoted daily if necessary, which allows us to actively compete for business.

Operations

Late in 1987 we announced plans for a major change in the way in which the operation of our railroad is managed. We plan to reduce the number of operating divisions from eleven to six, resulting in a more efficient and streamlined railroad. Plans include concentration of dispatching facilities, crew-calling operations and freight office functions. This concentration will enable us to move quickly to adapt state-of-the-art communications and dispatching technology that will improve the safety and reliability of train operations. A network of satellite operating



New marketing and sales programs combined with faster schedules and improved service to lure new traffic off the highway in 1987. Santa Fe Railway handled nearly 800,000 trailers and containers, an increase of 13.4 percent over the previous year.

Our Quality Service Network is operated by three-man crews who operate over greater distances than those on conventional trains. This highway-competitive service attracted approximately 55,000 trailers and containers in 1987.





Computer-aided dispatching systems in division operating centers play an important role in improving efficiency of train operations.

Over 5,000 miles of track were resurfaced in 1987, using equipment such as this high-production tamper which can level and realign nearly a half-mile of track in one hour.

offices will remain at key points to provide local contacts for billing, customer service and other operating information. It will take up to three years to complete the reorganization.

A major change is also planned in the mechanical maintenance and repair area. Future locomotive remanufacturing and heavy repair will be performed mainly at San Bernardino, California, and heavy freight car repair at Topeka, Kansas. Locomotive repair facilities at Barstow, California, Kansas City, Kansas, and Cleburne, Texas will be used primarily for light repairs. We also plan to streamline our mechanical and civil engineering staffs.

Our physical plant and fleet were maintained in excellent condition during 1987. We laid 245 miles of new and 241 miles of reconditioned rail, replaced 1.7 million ties and resurfaced about 4,600 miles of track. We plan to continue our ongoing program of maintaining the railroad during 1988. We also plan to purchase 40 new high horsepower diesel locomotives, remanufacture approximately 40 locomotives,

acquire new intermodal flat cars which collectively will be capable of handling 1,000 trailers or containers, and acquire 150 multi-level cars for motor vehicle transportation. Other improvements contemplated include changes in our fueling facilities to make that operation more efficient and reduce time spent in refueling locomotives.

Employee Relations

Average employment for the year was 22,182, down from 23,965 a year earlier, despite the fact that our carloadings were up six percent. At year end employment stood at approximately 21,200 reflecting reductions made late in the year. Reductions were across the board, and included both labor and management personnel.

Efforts to improve operating efficiency have resulted in progress on several fronts. We have continued programs designed to run freight trains greater distances without changing crews. Some of these "run-throughs" have been implemented, while others await completion of labor agreements or arbitration of provisions in existing agreements.

Another measure of efficiency shows that we called 38 percent fewer train crews in 1987 than in 1980. A minor portion of this decrease reflects a one percent reduction in revenue ton-miles for that period, but for the most part the improvement resulted from increased efficiency in making up and handling trains and in the use of yard engines.

Under existing labor agreements we can reduce crews from four to three employees, if there are no qualified employees on furlough. Because of efforts to reduce the total number of trains through improved scheduling, longer runs and longer trains, we had been furloughing more workers than were leaving through attrition. Recently we have been expediting attrition by offering to buy out the rights of employees through severance payments.

As a result of all these efforts, in 1987 we achieved a 16.2 percent increase in revenue ton-miles per employee, the greatest year-by-year improvement since World War II.

Labor agreements are up for renegotiation beginning April 1, 1988. In the railroad industry existing agreements remain in effect until new contracts are reached, or until the parties decide that no agreement is possible and wend their way through the time-consuming provisions of the Railway Labor Act which include arbitration and cooling off periods. We have been pleased to recognize a more progressive attitude on the part of rail labor on several fronts, and are hopeful that agreements can be reached that will allow us to continue our plans to become more efficient and competitive. Past negotiations have been on an industry-wide basis. There are indications that some railroads may elect to negotiate individually this time. We are also seriously considering this alternative.

Our 3,020-mile refined products system represents the core of our pipeline operations. It is the largest products pipeline system in the Western United States, transporting gasoline, diesel and jet fuel in Oregon, California, Nevada, Arizona, Texas and New Mexico. In 1987 this system generated nearly 70 percent of pipeline revenues and operating income. As part of the overall restructuring of Santa Fe Southern Pacific Corporation, we concluded that it is in the best interest of our stockholders to divest our non-petroleum pipelines and concentrate on this core business, which has excellent growth potential.

Most of this divestiture was completed in early 1988 with the sale of the 811-mile Chaparral System, which delivers natural gas liquids from Eastern New Mexico and West Texas to Houston, and the 1,943-mile Gulf Central System, which transports anhydrous ammonia fertilizer from the Gulf Coast

Pipeline Data			
	1987	1986	1985
Operating income (millions)	\$ 87.1	\$117.2	\$100.0
Capital expenditures (millions)	\$ 54.6	\$ 54.0	\$ 81.4
Refined petroleum products carried annually (million barrels)	344.1	324.7	297.8

to the Midwest. We are negotiating the sale of the 273-mile Black Mesa Pipeline, which delivers coal slurry from Arizona to a power plant in Nevada.

Pipeline operating income from the refined products system for 1987 would have exceeded the previous year by about four percent, except for a \$29.1 million reserve we established. This conservative accounting step was taken to provide for refunds that may be required as a result of an adverse initial ruling by the administrative law judge in a Southern Pacific Pipe Lines rate case being litigated before the Federal Energy Regulatory Commission. This case, which is now being reviewed by the Commission, involves a rate increase which became effective in 1985 on movements from Los Angeles and El Paso to Phoenix and Tucson. Whether refunds will actually be required will depend on the final outcome of this case, which could be several years from resolution, barring settlement.

Capital expenditures in 1987 for the refined products system totaled \$48.7 million. Major projects included installation of 23 miles of 12-inch pipeline between Sacramento and Roseville, California, and most of the work on 20 miles of 16-inch pipeline which will expand capacity between Los Angeles and San Diego and enhance our ability to serve the rapidly-growing markets in Orange County and San Diego. Storage tanks and truck-loading racks were installed at several locations. We have completed about 70 percent of a \$14 million installation of a new supervisory control and data acquisition (SCADA) system which will enhance both efficiency and safety

throughout the system.

Our entire products system serves growth areas, but that is especially true for the lines to Phoenix. We last expanded capacity from the Los Angeles area to Phoenix by 16 percent in October, 1985, but products tendered for shipment have consistently exceeded capacity since that time. Studies indicate that growth in refined products consumption in this market will continue to exceed the national average.

To meet this demand we have prepared plans for installing an additional 256 miles of 20-inch pipeline between the Los Angeles area and Phoenix. This expansion would increase our capacity by approximately 70 percent and ensure our ability to serve the market adequately into the next century. We plan to begin construction on this project in the Summer of 1988 and have the new line in service early in 1989. We are convinced of the need for this expansion, which is supported by most of our shippers and Arizona governmental authorities.



Raymond J. Hunt
President
Santa Fe Pacific Pipelines, Inc.



A new supervisory control and data acquisition system is enhancing both efficiency and safety throughout our refined products pipeline system, including this terminal at Colton, California.



O. G. Linde
President and
Chief Executive Officer
Santa Fe Pacific Realty
Corporation

The mission of Santa Fe Pacific Realty Corporation is to maximize the value realization of the real estate assets of the company through staged development and disposition. The real estate company manages a portfolio of properties of its affiliated land group companies, as well as properties that become surplus to the needs of Santa Fe Southern Pacific Corporation's other subsidiaries, except for those properties owned by Southern Pacific Transportation Company.

Operating income from real estate activities in 1987 was \$319.8 million, about equal with the \$321.7 million a year earlier. Of the 1987 amount, \$114.9 million was attributable to real estate activities of Southern Pacific Transportation Company, which is currently in the process of being divested, as outlined in the joint message from the chairman and president.

Approximately 65 percent of our revenue was achieved through sales and joint ventures, while the balance came from rentals.

New Strategy Implemented

We have believed for some time that the ultimate value of our considerable real estate holdings was not being reflected in the company's stock price. Therefore we reviewed our situation with a goal of developing a strategy that would maximize the value of our considerable assets for our stockholders. That review was a part of the company's overall restructuring plan, and resulted in a significant change of direction for real estate activities.

As reported in last year's Annual Report, our strategy was to achieve greater income stability through growth in rental revenue, both through our building and acquisition programs. Since undeveloped land in a portfolio of properties is difficult for investors to value, our objective had been to convert as much non-income producing property to income producing property as rapidly as possible to provide earnings and recognition of value. However, as we continued to analyze this strategy, it became clear that the magnitude of properties we were holding for development could not be converted to recognizable value within a time horizon that provided optimum value realization to our shareholders.

Value in land is created through a series of steps: planning, securing development rights through an often protracted city and governmental process, installing infrastructure, constructing buildings, leasing space, and managing buildings. The entire development process, although it creates value through each step, does not result in value recognition to our shareholders until earnings are reported, either through property rents or property sales. This process can often take a number of years, and is heavily influenced by our success in securing development rights, as well as macro and micro economic considerations in the real estate industry.

To maximize value to our shareholders, we considered various alternatives, including a Real Estate Investment Trust which would be comprised of a significant portion of our developed properties. After considering all of the alternatives, we concluded that a "Special Sale" of approximately \$800 million of our developed and prime undeveloped properties, to support the February 1988 Special Dividend to our shareholders, created the maximum value from these assets. We also concluded that we would continue to create value in our remaining major properties by planning, securing rights, and, in some cases, installing infrastructure. However, due to the relatively long time horizon involved in constructing buildings and then leasing and eventually selling these buildings, all in the right economic environment, we determined the appropriate strategy was to discontinue our building development program, as well as our building acquisition program, and instead focus on a program of selling our holdings at the optimum time.

Current plans call for sales of approximately 5,000 acres of developable land over the next five years, some 4,500 of which we expect to sell in 1988. We also expect to sell about 8 million square feet of buildings we now own, with a substantial portion to be sold in 1988 and the balance spread over the following four years. In addition, we plan to sell a portion of our outlying lands that have no immediate potential for development, and our agricultural land in the San Joaquin Valley of California. These total sales are projected to generate \$1 billion in revenues in 1988 and about \$200 million in each succeeding year.

We expect that by 1992, the company will still have valuable real estate assets. We will still own about 2,000 acres of developable land, nearly 26,000 acres of surplus property, about 2.2 million acres of outlying land, and 377 developable acres which comprise major projects such as the Mission Bay property in San Francisco and our 20 acres in downtown San Diego. We anticipate that future development efforts will be in the form of joint ventures and will involve our major holdings.

Real Estate Data

	1987	1986	1985
Revenues (millions)			
Sales	\$266.6	\$250.6	\$302.0
Rentals	157.8	135.7	123.8
Joint venture income	24.6	13.0	6.2
Other	1.9	30.4	4.3
Total	\$450.9	\$429.7	\$436.3
Operating income (millions)	\$319.8	\$321.7	\$341.7

This plan reflects the company's desire to expedite the distribution to stockholders of the value of its assets, as proceeds from these sales will be used in good measure to fund obligations incurred as a

result of the special dividend distributed earlier this year.

Major Properties

The company owns a number of large parcels in or near major California metropolitan areas that have potential for providing long-term development opportunities, provided local environmental and regulatory concerns can be met. These projects will take a number of years to develop fully.

Construction will be completed in 1988 on an Embassy Suites Hotel in San Diego, which is shown under construction on the cover of this report. We are the managing partner and half-owner in this project together with the Holiday Corporation. Also on our 20-acre properties at San Diego we expect to break ground during 1989 on a 30-story, 580,000 square foot office building to be called the Great American Tower. We will be the managing partner and half-owner in this building along with the Great American Development Company, a subsidiary of Great American First Savings Bank. We anticipate that over 40 percent of this space will be precommitted when construction commences. Construction of other office and commercial components on this important project in San Diego is expected in the future.

During 1988 we expect to complete the necessary steps to obtain regulatory approval of our proposed 208-acre Mission Bay project in San Francisco. Following that, a project referendum, as well as a public vote on an exemption from the restrictions of San Francisco's "Slow Growth Initiative" will most likely occur. If the outcome of such a referendum is successful, infrastructure installation could begin in 1989 with construction beginning in late 1989 or 1990.

Other major properties in our portfolio include approximately 325 acres on the east shore of San Francisco Bay in the cities of Albany, Berkeley and Emeryville, and 700 acres in Fremont.

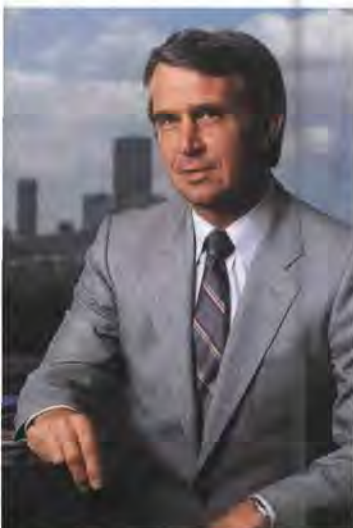
A recent U.S. Supreme Court decision which would require compensation for damages to a landowner whose property has been taken by a land-use regulation could have an impact on restrictions that have hampered our ability to develop properties in the East Bay. We still hope to ready some of these properties for development, but it now appears possible that some may be condemned and sold to public agencies for use as parks. In one instance where our development efforts have been rebuffed and no reasonable offer to purchase has been forthcoming, we have filed an inverse condemnation suit in an effort to realize value from the property.

Agricultural Lands

In 1988 we will begin disposing of a portion of our agricultural holdings in the San Joaquin Valley, due to the mandatory divestiture of 79,000 acres of these acres under federal water reclamation law. We anticipate that these 79,000 acres will be sold by the end of 1990.



Buildings totaling 8 million square feet are being sold to accelerate realization of value from real estate assets. Examples include the Centerpointe project in San Diego (top) and this office center (left) in Orange, California.



James L. Payne
President
Santa Fe Energy Company

We reported operating income of \$46.5 million from petroleum activities in 1987, a healthy rebound from the operating loss of \$154.5 million reported in 1986.

In last year's report we stated Santa Fe Energy Company's basic business assumption that recent changes in the industry were not temporary, but represented a long-term trend in which prices would fluctuate but show increasing improvement over time, and profit margins would remain under pressure while OPEC reasserted its control over world oil markets. That assumption proved to be accurate in 1987, as oil prices improved only modestly from 1986 and gas prices continued to decline. Our improved results were achieved primarily through increased production and tight operating cost controls, plus a reorganization of the company that included a reduction of nearly 30 percent in our work force since mid-1985.

The severe downturn in petroleum prices during 1986 and 1987 led to failure or weakened positions for many domestic oil and gas companies. This changed business environment also offered opportunities for a financially stable company like Santa Fe Energy. In mid-1986 we began to capitalize on those opportunities by aggressively pursuing the acquisition of producing oil and gas properties with both proved and potential reserves. Through 1987 we have spent over \$225 million for such properties, adding approximately 30 million oil equivalent barrels of proved reserves at prices which averaged less than \$6.00 per barrel. Many of these properties have promising future development potential which should add significant additional reserves over time. Although oil prices have stabilized to some degree, overall industry conditions still present selective acquisition opportunities. Our acquisition program will continue to be part of our strategy for growth in 1988.

We continue to believe that petroleum is a strong core business, and have positioned ourselves to be profitable under present industry conditions with potential for strong growth when price improvements occur. At the close of 1987, we have record high petroleum reserves; we are experiencing historically low finding costs; and we continue to reduce operating expenses.

Master Limited Partnership

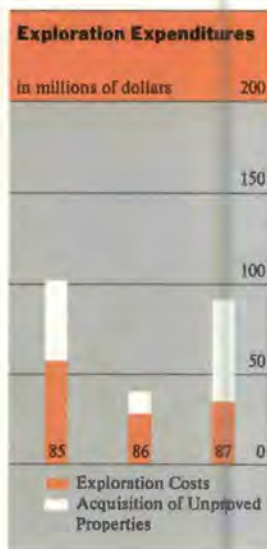
Santa Fe Energy Partners, L. P., a publicly traded limited partnership, was formed from certain assets of Santa Fe Energy Company in early 1986. Approximately 18 percent of the units in that partnership were owned by the public at the end of 1987, with the company owning the balance. An affiliate of Santa Fe Energy Company acts as the Managing General Partner. Statistical results in this report exclude the publicly-owned portion of the Partnership, which will publish its own annual report.

Exploration

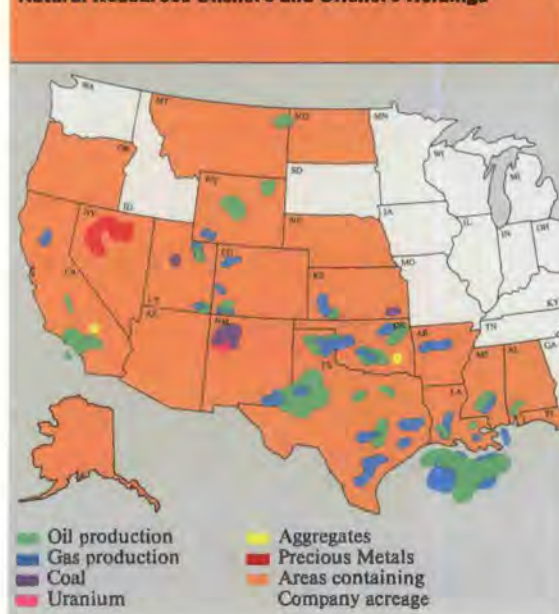
Our exploration program has been tailored to absorb the effects of lower product prices. We directed investments into lower-risk prospects and became more selective in those drilled, diligently managed capital expenditures, and maintained our strategy of leveraging land assets. The result was increased net wildcat drilling exposure with an improved success rate.

We have expanded our opportunity base by initiating an aggressive farm-in program which provides access to properties without associated lease bonus costs. This program was a major success in the Gulf of Mexico where three of the four wildcat discoveries in which we participated were the result of farm-ins. Our 1987 onshore program was highlighted by a 55,000 acre farm-in located between our expanding Britt Ranch Field in the Texas Panhandle and our interests in the large Southwest Libbey Field in western Oklahoma. We identified a number of development and potential exploration prospects on this acreage which will be drilled in the near future. We plan to continue this farm-in strategy throughout 1988.

Each onshore district registered exploration discoveries in 1987. The Permian Basin District had its best year ever, registering seven new field discoveries with working interests ranging from 33 to 85 percent. A highlight of those discoveries is the North Hume prospect in Lea County, New Mexico. The discovery well which was completed in January, 1987, tested 670 barrels of oil and 600 thousand cubic feet of gas per day. A development well to the north confirmed hydrocarbon accumulation and another exploratory well, drilled over one mile south in early 1988, tested oil in the same reservoir. We have a 50 percent interest and operate 2200 acres in the North Hume prospect.



Natural Resources Onshore and Offshore Holdings



Both the Rocky Mountain District and Mid-Continent District were involved in new field discoveries with interests ranging from 10 to 50 percent.

The remainder of our domestic activity involved managing frontier exploration on almost ten million acres of oil and gas rights owned or controlled by Santa Fe Energy. Large parcels in California, Nevada, and New Mexico are being explored through exploration agreements with industry partners at little or no cost to us.

At the end of 1987, our international holdings included 1.4 million net acres. New agreements in Pakistan and Argentina are expected to be finalized in 1988 which will increase our holdings substantially. Five exploration wells are planned for 1988 including three in Indonesia, one in Tunisia, and one in Colombia.

Production and Development

Oil production in 1987 averaged 52,400 barrels a day, the highest in our history. Gas production averaged 80.8 million cubic feet per day. Because of the oversupply of gas in the United States, and the resultant lack of market, we withheld a portion of our production rather than sell it under such depressed conditions. Gas prices recovered somewhat during the seasonally colder fourth quarter, and we resumed production on some of our shut-in wells as a result. While it is impossible to predict with certainty when the "gas bubble" will disappear, it seems clear that the gap between supply and demand is narrowing.

As oil prices deteriorated in the past two years we analyzed all of our field operating procedures to identify potential savings. Many procedures were changed and many wells that became uneconomical under the current pricing structure were shut in.



Those changes, combined with reduced costs for supplies and services, further improved operating margins.

During 1987 we drilled 132.4 net development wells, of which more than 120 were successful. At year end we had 4,815 net producing oil wells and 206 net producing gas wells. Our finding and development costs averaged \$6.09 per oil equivalent barrel, the second lowest in recent history and the third consecutive year of reduced costs.

The most significant part of our development program took place in California where we continued our high level of activity in the Midway-Sunset Field. In addition, water flood projects were initiated in the South Belridge Field in the San Joaquin Valley and in the Rosecrans Field in the Los Angeles Basin. We also expanded our polymer flood program in the Candy Draw Field of Wyoming and drilled nine wells as part of our long range development program on the Britt Ranch in the Texas Panhandle.

As a result of our exploratory, development and acquisition efforts we more than replaced reserves produced during the year. We added 43.6 million oil equivalent barrels to reserves, compared with 23.1 million oil equivalent barrels in 1986. This achievement represents the successful accomplishment of an important goal in our efforts to position the company for the future since the long-term success of any oil and gas company depends on its ability to replace the reserves it produces.

Santa Fe Energy is a leader in the use of enhanced recovery techniques, which are used to improve production from wells like this one in the Permian Basin of West Texas.

Petroleum Data			
	1987 ⁽¹⁾	1986 ⁽¹⁾	1985
Operating income (loss) (millions)	\$ 46.5	\$(154.5)	\$120.3
Costs incurred (millions)			
Acquisition of properties			
Proved	\$130.9	\$ 47.1	\$ 2.9
Unproved	57.4	12.2	44.4
Exploration costs	35.0	29.0	57.6
Development costs	80.9	81.9	127.0
Total	\$304.2	\$170.2	\$231.9
Crude oil production (thousand barrels per day)	52.4	47.2	49.9
Average price per barrel	\$14.01	\$11.56	\$22.20
Natural gas production (million cubic feet per day)	80.8	61.2	87.1
Average price per thousand cubic feet	\$ 1.65	\$ 2.16	\$ 3.04
Proved reserves			
Crude oil (million barrels)	139.3	124.4	131.3
Natural gas (billion cubic feet)	217.2	191.6	201.0
Net wells drilled			
Exploratory	18.6	17.0	31.3
Development	132.4	218.4	247.4

(1) Data excludes the publicly-owned portion of properties placed in a master limited partnership





Richard T. Zitting
President
Santa Fe Pacific Minerals
Corporation

The Lee Ranch Coal Mine is positioned for growth as existing customers increase purchases in future years under existing contracts. Production increased 27 percent in 1987, primarily as a result of a one-time spot sale of 400,000 tons to an Arizona utility.

Santa Fe Pacific Minerals earned significantly higher operating income in 1987, due to higher royalty income, increased coal sales and continuing productivity improvements at the company's Lee Ranch Mine. Operating income was \$36.4 million, compared with \$26.5 million in 1986.

During 1987, we continued to cope with a crowded buyer's market for southwestern coal while pressing forward in our search for new business opportunities in coal, precious metals and industrial minerals. This activity resulted in the purchase of an aggregates business during 1987, and is resulting in new revenues from a Nevada silver property in 1988.

Most of our revenues still come from our basic business of coal production and leasing. Since 1984, we have been a major western coal producer with our Lee Ranch Mine in northwest New Mexico.

Our current asset base includes more than eight million acres of mineral rights and 720 million tons of coal reserves, including the Lee Ranch Mine. Of the total amount, 490 million tons are under lease.

Coal

Lee Ranch Mine delivered 1.9 million tons of coal, up 27 percent from the 1.5 million tons delivered during 1986. Demand for coal by the mine's two principal utility customers increased only slightly, but a one-time spot sale of 400,000 tons to an Arizona utility provided most of the increase. Production efficiency continues to rise at Lee Ranch due to careful mine planning, equipment modifications and high productivity.

Although we expect coal demand to remain soft and competition for customers keen, we are positioned for substantial growth in the coal business in the years ahead as our two existing customers increase their purchases under existing contracts and other markets improve.

Meanwhile, we continue to aggressively seek

other sales opportunities for our coal, such as the 400,000-ton sale made in 1987, among prospective utility and industrial customers in the western United States.

In March, we completed a land exchange agreement with the federal government that allowed us to "block up" our Lee Ranch holdings in a way that should permit operating efficiencies at the mine in coming years.

Income from coal royalties, which increased in 1987, is expected to increase again in 1988. A large portion of that income relates to a coal lease agreement with a subsidiary of Texas Utilities Company, which has made all scheduled payments but is litigating the validity of the agreement.

Hard Minerals Data

	1987	1986	1985
Operating income (millions)	\$36.4	\$26.5	\$26.9
Capital expenditures (millions)	\$ 6.7	\$ 6.7	\$ 7.2
Proved and probable coal reserves (million tons) year end			
Leased to others	490	490	494
Unleased	230	273	274

Metals and Other Minerals

In January of 1988, the Trinity silver mine in Nevada, in which we hold a 50 percent interest, produced its initial bullion, representing the first of what may total over four million ounces of silver. The project will contribute to operating income beginning this year and is expected to have a total life of two years. We also approved development during 1988 of a gold property in Nevada.

During 1987, we entered a new business with the purchase, from another SFSP affiliate, of McKee Products, Inc., a producer of railroad ballast and industrial aggregates. We plan to expand this business as suitable opportunities arise.

We also continue to seek new opportunities in other specialized industrial minerals, such as calcium carbonate, silica, talc, specialty clays, kaolin, soda ash and salt.



Twelve Months Ended December 31	1987	1986	1985	1984	1983
					(In Millions)

Revenues by Business Groups
Natural Resources

Petroleum Production and Marketing	\$ 331.2	\$ 256.9	\$ 516.9	\$ 515.7	\$ 510.9
Hard Minerals	87.5	72.1	93.1	31.4	23.5

Real Estate

450.9	429.7	436.3	413.5	288.8
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Transportation

Rail					
Santa Fe	1,970.8	1,954.0	2,146.6	2,303.7	2,081.8
Southern Pacific	2,305.6	2,271.6	2,464.5	2,649.1	2,363.8
Pipeline	213.1	239.9	209.1	193.4	172.7
Truck	89.3	90.2	81.3	83.8	105.7
Revenues	\$5,448.4	\$5,314.4	\$5,947.8	\$6,190.6	\$5,547.2

Operating Income (Loss) by Business Groups
Natural Resources

Petroleum Production and Marketing	\$ 46.5	\$ (154.5)	\$ 120.3	\$ 113.4	\$ 131.1
Hard Minerals	36.4	26.5	26.9	14.1	14.1

Real Estate

319.8	321.7	341.7	301.6	217.6
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Transportation

Rail					
Santa Fe	176.8	170.8	145.5	211.4	175.7
Southern Pacific	90.0	14.1	14.6	51.2	4.6
Pipeline	87.1	117.2	100.0	84.9	74.3
Truck	.6	(10.7)	1.6	2.1	(8.8)
Rail Restructuring Costs	—	(914.1)	—	—	—
Operating income (loss)	\$ 757.2	\$ (429.0)	\$ 750.6	\$ 778.7	\$ 608.6

Santa Fe Southern Pacific Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

1987 Compared to 1986

Santa Fe Southern Pacific Corporation ("SFSP") reported net income in 1987 of \$373.5 million or \$2.37 per share, compared with a net loss of \$137.9 million or \$.84 per share in 1986. The prior year results reflect several unusual events. First, 1986 includes significant charges taken independently by The Atchison, Topeka and Santa Fe Railway Company ("Santa Fe Railway") and by Southern Pacific Transportation Company ("SPT") for restructuring of their rail operations. Second, the prior year includes certain write-downs of oil and gas assets related to depressed conditions in that industry. Finally, it includes a \$120.9 million gain on the sale of Kirby Forest Industries, Inc. ("Kirby"). However, even when all three of these items are removed, net income for 1987 was significantly better than the prior year.

Net income from continuing operations was \$345.7 million or \$2.19 per share compared with a loss of \$285.3 million or \$1.73 per share. Income from discontinued operations was \$27.8 million or \$.18 per share versus \$147.4 million, including the Kirby gain, or \$.89 per share. Included within discontinued operations in both years are the results of Bankers Leasing and Financial Corporation which was sold in January 1988, Santa Fe Pacific Timber Company, the sale of which is expected to close in February 1988, and Robert E. McKee, Inc., which was sold during 1987. In addition to these companies, the results of and gain on sale of Kirby are included in 1986 discontinued operations.

The transportation group reported operating income of \$354.5 million, an improvement of \$63.1 million from last year, excluding rail restructuring costs. The primary reason for the improvement was increased earnings from rail operations. Operating income from Santa Fe Railway was \$176.8 million compared with \$170.8 million last year. Revenues improved 1%, the net of a 6% improvement in carloadings offset by a 5% decline in revenue per carload. Significant carloading increases were experienced in merchandise (including appliances and manufactured goods) and grain, while decreases were experienced in coal and vehicles and parts. Carloadings of containerized freight were also higher. Operating expenses were approximately equal to last year in spite of a 15% increase in fuel prices and higher transportation labor costs. Additionally, 1986 operating expenses include \$10.2 million in expense related to employee severance. Employment at Santa Fe Railway declined 5% during 1987 to approximately 21,200 employees at year end.

For 1987, SPT reported income from rail operations of \$90.0 million, up substantially from the \$14.1 million of last year. Revenues improved 1%, the result of a 3% increase in carloadings offset by a 2% decline in revenue per carload. Major carloading increases occurred in grain and merchandise, with smaller increases in vehicles and parts and chemicals. Operating expenses declined \$41.9 million, or 2%, primarily due to the recording of \$73.6 million in employee separation and severance expenses in 1986. Lower payroll costs in 1987 were partially offset by increased expenses for material, fuel and equipment rentals. SPT's average price per gallon of fuel was 13% higher. Rail employment levels at SPT declined by 8% during 1987. The common stock of SPT is presently held in an independent voting trust. See Note 2 of "Notes to Financial Statements" for further information.

Operating income from pipeline activities was \$87.1 million compared with \$117.2 million last year. The major reason for the decline was the reversal of \$29.1 million in revenues which are now subject to possible refund under an April 30, 1987 administrative decision by the Federal Energy Regulatory Commission involving Southern Pacific Pipe Lines, Inc. The decision has been appealed to the full Commission

and will not become effective until the Commission rules. Exclusive of this charge, results for the pipeline group were approximately even between years.

Operating income from SPT's trucking activities was \$.6 million compared with a loss of \$10.7 million last year. Results for 1986 include a \$16.0 million pension plan withdrawal charge. Shipments handled increased but were offset by lower revenue per truckload.

Operating income from real estate activities was \$319.8 million, approximately even with the \$321.7 million reported last year. Both years include substantial amounts related to property sales as well as rental and joint venture activities. The real estate operations of SPT produced operating income of \$114.9 million in 1987 and \$118.4 million in 1986, while those of Santa Fe Railway were \$28.5 million and \$32.7 million in 1987 and 1986, respectively.

Results from petroleum production and marketing activities showed the most dramatic improvement of all groups. Operating income was \$46.5 million in 1987 compared with a loss of \$154.5 million in 1986. Operating expenses in 1986 included \$132.8 million in impairments compared with only \$3.1 million in 1987. An impairment is the write-down taken when the net book value of an oil or gas field is reduced to equal the estimated undiscounted future net revenues from that field. However, even after excluding impairments, results in the current year were substantially better. Revenues of \$331.2 million were 29% higher than last year. The average price per barrel of oil was \$14.01, versus \$11.56 in 1986 and daily oil production was 52,400 barrels, compared with 47,200 barrels in 1986. Gas prices were \$1.65 per thousand cubic feet, compared with \$2.16 per thousand cubic feet in 1986. Daily gas production of 80.8 million cubic feet was up 32%. The increases in oil and natural gas production are the result of production from properties acquired late in 1986 and in the first half of 1987, as well as reduced curtailments. Operating expenses exclusive of impairments were approximately even between years. Higher production costs due to increased levels of production were offset by declines in general and administrative and other expenses. These expense reductions were principally the result of cost containment measures taken by the company in the past.

Hard minerals operating income of \$36.4 million was \$9.9 million better than last year. The majority of this improvement was due to a higher level of coal shipments as well as the write-off of certain costs in 1986.

Other income—net of \$3.6 million was \$11.2 million below last year primarily due to a favorable settlement of litigation recorded in 1986.

1986 Compared to 1985

Santa Fe Southern Pacific Corporation reported a net loss for 1986 of \$137.9 million compared with net income of \$469.6 million in 1985. Net loss per share was \$.84 versus net income per share of \$2.67 in 1985. These lower results reflect significant charges taken independently by Santa Fe Railway and by SPT for restructuring of their rail operations as well as the depressed conditions in the oil and gas industry. Included in these results are discontinued operations from SFSP's sale of Kirby Forest Industries, Inc. Net income from discontinued operations was \$147.4 million in 1986 (including a net gain from the sale of Kirby of \$120.9 million) and \$30.8 million in 1985. Loss from continuing operations was \$285.3 million, or \$1.73 per share, in 1986 compared with income of \$438.8 million, or \$2.50 per share in 1985.

The transportation group reported an operating loss of \$622.7 million in 1986, including charges of \$914.1 million related to the restructuring of the railroad operations of Santa Fe Railway and SPT. These charges reflect plans by Santa Fe Railway and SPT to be carried out over a period of several years to eliminate unprofitable lines and facilities as well as equipment, and to reduce employment levels. It is anticipated that these actions will reduce rail operating costs in the future.

These charges are similar in nature to those recorded by most major railroads, resulting from an industrywide problem of excess facilities, equipment and personnel. Of the total charge, \$312.8 million related to Santa Fe Railway and \$601.3 million applied to SPT.

Santa Fe Railway's operating income before restructuring costs was \$170.8 million, up 17% from the \$145.5 million of 1985. This increase was the net result of a 9% decline in revenues and an 11% decrease in operating expenses. Revenues were adversely affected by a 3% decline in carloadings and a 4% drop in revenue per carload. Carloadings of merchandise, which is traditionally Santa Fe Railway's largest commodity, declined 6%. Additionally, declines were experienced in coal and vehicles and parts, two other major commodities. An increase of 14% occurred in grain carloads due primarily to government grain relocation movements and special marketing programs. Santa Fe Railway's carloadings of containerized freight were approximately even with the previous year. The expense decline primarily occurred in transportation and equipment costs, with other expense categories remaining flat between years. The major reasons for the expense declines were lower fuel costs, reflecting a 38% decline in fuel price and an 8% decrease in usage, and lower employment costs primarily resulting from an 8% reduction in the number of employees.

For 1986, SPT reported income before restructuring costs of \$14.1 million, approximately the same as 1985, as both revenues and operating expenses declined by 8%. Carloadings fell by 5% while revenue per carload dropped by 3%. SPT experienced a 45% decline in coal shipments due to the loss of a major transportation contract, as well as a 15% decrease in vehicles and parts. All other major commodities were approximately even with 1985. The major causes for the expense decline were fuel and employment costs. SPT's average price per gallon of fuel declined 39% and fuel consumption decreased 4%. Employment levels were 8% lower at year-end 1986; however, partially offsetting this were charges of \$73.6 million for employee buyouts and separations in 1986 versus \$8.0 million in 1985.

Operating income from pipeline activities was \$117.2 million compared to \$100.0 million recorded in 1985. This 17% improvement is primarily attributable to SFSP's refined petroleum product pipelines, which experienced a 9% increase in throughput and a 14% increase in average tariffs. Other pipeline activities generated operating income approximately even with 1985.

The operating loss from SPT's trucking activities was \$10.7 million compared to 1985's income of \$1.6 million. A \$16.0 million pension plan withdrawal charge in 1986 was the cause of the decrease.

Real estate operations had operating income of \$321.7 million, down \$20.0 million from the \$341.7 million reported in 1985. The majority of this decrease was due to a decline in real estate sales made by SPT. The real estate operations of SPT produced operating income of \$118.4 million in 1986 and \$140.9 million in 1985, while those of Santa Fe Railway were \$32.7 million and \$56.3 million in 1986 and 1985, respectively. SFSP's mix of real estate operations changed in 1986 compared with 1985. Less revenue from sales was partially offset by increased rental income and a sale of an interest in a geothermal joint venture.

Petroleum production and marketing operations reflected the depressed conditions of the oil and gas industry. An operating loss of \$154.5 million was reported, compared with income of \$120.3 million in 1985. Revenues of \$256.9 million were approximately half of those recorded in 1985. Revenues have been adversely affected by the continued deterioration of oil and gas prices, reduced levels of production, and the exclusion of approximately \$23 million attributable to the publicly owned portion of Santa Fe Energy Partners, L.P. ("Partnership"). Average daily oil production was 47,200 barrels per day compared with 49,900 in 1985, while the average price realized per barrel of \$11.56 was 48% below 1985. Natural gas production fell 30% to 61.2 million cubic

feet per day, reflecting a management decision to curtail production in situations where it was deemed imprudent to sell at current prices, as well as the exclusion of the publicly owned portion of production from properties placed in the Partnership. Operating expenses, which included impairments of \$132.8 million, were 4% higher. Without the impairments, expenses would have decreased by 30% and the operating loss would have been \$21.7 million. With the exception of impairments, all major expense categories were lower in 1986.

Hard minerals operating income of \$26.5 million was approximately even with 1985. Revenues decreased 23% due to a 29% drop in coal shipments. Demand for power generated by coal declined after oil and natural gas prices fell precipitously in early 1986. Operating expenses decreased by \$20.6 million due primarily to the lower level of coal sales as well as inclusion of a \$5.3 million write-off related to a gold mining project in 1985.

The results for 1986 reflect lower investment tax credit benefits as a result of the Tax Reform Act of 1986. Investment tax credit benefits included in the 1985 tax provision were \$66.5 million. Investment tax credit benefits included in the 1986 tax provision were \$18.0 million.

Financial Condition

As discussed under Restructuring Program, SFSP's future financial condition will be substantially different from what it historically has been. The following discussion relates to the historical financial condition through December 31, 1987.

For the year ended December 31, 1987, cash provided by operations was \$1,233.9 million compared with \$1,423.0 million in 1986 and \$1,294.5 million in 1985. These amounts were sufficient to cover the majority of capital expenditures and dividend payments in each of the three years. Cash provided by operations has generally been derived from the net earnings of SFSP, exclusive of substantial noncash charges, including depreciation, depletion and amortization and provisions for deferred income taxes.

Capital expenditures in 1987 were \$1,153.7 million compared with \$1,061.4 million in 1986 and \$1,078.3 million in 1985. Over this three-year period, approximately 52% of such expenditures has been for improvements and additions to track structure and roadway properties, 10% has been for railroad equipment, 19% for oil and gas exploration and development, with the remaining 19% relating to real estate, pipelines and other operations. The majority of these capital expenditures have been financed through internally generated funds. Long-term debt levels, including current maturities, have been \$1,870.4 million, \$1,921.5 million and \$1,794.4 million at December 31, 1987, 1986 and 1985, respectively. As of December 31, 1987, SFSP had an unused financing facility of \$475.0 million which has subsequently been terminated as a part of the restructuring.

Dividends paid to stockholders in the years 1987, 1986 and 1985 were \$156.8 million, \$164.9 million and \$175.1 million, respectively. The annual dividend rate for all three years was \$1.00 per share. Total dividend payments have declined over the three-year period due to SFSP's share repurchase program which began in 1984. During 1987, approximately 1.5 million shares of common stock were repurchased at a cost of \$61.9 million. Approximately 12.9 million shares were repurchased in 1986 for \$425.8 million and 9.8 million in 1985 for \$302.1 million.

At December 31, 1987, SFSP had a working capital deficit of \$319.5 million compared with working capital of \$209.4 million at December 31, 1986 and \$327.8 million at December 31, 1985. The primary causes for the decrease since 1985 have been treasury stock purchases, incurrence of employee separation and severance costs related to rail restructurings, and a slightly higher level of capital expenditures.

Due to the capital-intensive nature of SFSP's businesses, inflation generally causes an understatement of operating expenses, due to

depreciation being based upon the historical cost of assets. Annual charges for depreciation have approximated \$600 million while SFSP has expended well in excess of \$1 billion per year on capital expenditures, essentially to replace productive capacity.

In accordance with present accounting rules, deferred taxes have been provided at tax rates in effect in the years in which the timing differences arose. These rates have generally been higher than those at which such differences may reverse. Changes in accounting rules for deferred taxes have been issued but will not be implemented until some future period, as allowed by such rules. However, when these rules are adopted, it is anticipated that there will be a substantial reduction in SFSP's deferred income tax liability.

Restructuring Program

On January 26, 1988, the Board of Directors of SFSP declared a dividend distribution of \$25 in cash plus \$5 principal amount of new senior subordinated debentures for each outstanding share. Payment of this dividend is an important step in SFSP's restructuring program which began during 1987. The restructuring program includes not only the dividend, but also the sale of a number of businesses and the incurrence of substantial amounts of debt, to be serviced from the business divestitures as well as ongoing operations of the company.

The cash portion of the dividend amounted to a total cash outflow of approximately \$3.9 billion, which will be primarily financed by a credit agreement which provides for a \$1.76 billion bridge loan facility and a \$1.9 billion reducing revolving loan facility. The bridge loan will be paid from after-tax proceeds received from the sale of non-core assets. The bridge loan must be reduced to \$1.4 billion by June 30, 1988 and terminates on June 30, 1989. The revolving loan facility must be reduced ratably over five years beginning February 16, 1989, through semi-annual payments, and must be terminated no later than February 16, 1994. Additionally, the credit agreement provides for a \$250 million working capital facility which also terminates no later than February 16, 1994. Interest rates under the credit agreement vary depending on options chosen by SFSP as well as certain other factors, but generally are tied to and include premiums over certain reference interest rates (e.g., prime rate).

The senior subordinated debenture portion of the dividend will increase long-term debt by \$782.5 million. These debentures bear interest at 16% and SFSP has the option to pay interest in the form of additional debentures rather than cash until 1994. From 1994 to 2003, when the debentures are due, all interest will be paid in cash. The company is required to redeem 20% of the debentures annually, commencing in 1999.

After payment of the dividend, SFSP's leverage will be substantially increased. As disclosed in Note 3 of notes to the financial statements, total debt is expected to approximate \$6.5 billion, while stockholders' equity will decline to about \$500 million. This increased leverage will require additional annual interest payments which are expected initially to approximate \$250 million, exclusive of the additional senior subordinated debenture interest payments. This increased interest cost is largely dependent upon the timing of sales of non-core subsidiaries and other assets used to reduce the bridge loan facility. Dividends in future years are limited to \$.10 per share per year.

The company's ability to satisfy its obligations, to reduce debt and to increase equity will be dependent upon its future performance, which will be subject to prevailing economic conditions and to financial, business and other factors, including factors beyond the control of the company, affecting the business and operations of the company. SFSP believes it will be able to meet its interest and principal obligations as they become due following the payment of the dividend.

In addition to the dividend and increased leverage, the restructuring program includes selling certain non-core businesses and

real estate assets. Businesses sold or to be sold include:

(1) Robert E. McKee, Inc. On September 30, 1987, the company announced it had completed the sale of Robert E. McKee, Inc., its general building contractor. The proceeds to the company from such sale totalled \$30 million.

(2) Bankers Leasing and Financial Corporation. On January 15, 1988, Bankers Leasing and Financial Corporation was sold for \$187.5 million.

(3) Santa Fe Pacific Timber Company. On October 9, 1987, the company announced a definitive agreement to sell Santa Fe Pacific Timber Company, which owns approximately 520,000 acres of timberland in northern California, to Sierra Pacific Industries for \$460 million. The sale closed in February, 1988.

(4) Non-refined Products Pipeline Companies. On January 14, 1988, the company announced a definitive agreement to sell certain pipeline companies, including Gulf Central Pipeline System and Chaparral Pipeline System to Koch Industries for \$196.5 million plus adjustments estimated at \$10-\$15 million. The sale closed in February, 1988. Black Mesa Pipeline, Inc. remains for sale.

(5) Southern Pacific Transportation Company. On December 28, 1987, the company announced that it had entered into a definitive agreement (the "SPT Agreement") for the sale of the stock of SPT to Rio Grande Industries, Inc., and one of its wholly owned subsidiaries (together, "Rio Grande") for \$1.02 billion in cash. SPT will retain approximately \$780 million in outstanding debt. The transaction is subject to ICC approval, due diligence and other customary conditions. Under the procedural schedule proposed by the ICC, review of the sale transaction could be completed by late summer, 1988. Rio Grande has until the end of March, 1988, to complete certain additional due diligence to determine if any matter of which it becomes aware during such period could cause the value of SPT to be less than the value assumed by it on the date of the SPT Agreement, and if so, Rio Grande may terminate the SPT Agreement.

In addition to divestiture of these businesses, SFSP has adopted a special real estate sales program that will result in approximately \$800 million in sales of existing buildings, developed and undeveloped land, and leased fee interests beyond normal sales levels. This special sale of properties in 1988 is expected to generate after-tax cash proceeds of approximately \$550 million based upon the properties currently identified for inclusion in the program.

After the above business divestitures and real estate sales are completed, SFSP intends to remain in the three core businesses of transportation, real estate and natural resources.

Common Stock Market Prices and Dividends

Santa Fe Southern Pacific common stock is traded on the New York, Midwest and Pacific Stock Exchanges. The quarterly price range per share for the years 1987 and 1986 is as follows:

	1987		1986	
	High	Low	High	Low
First Quarter	41	29 $\frac{3}{8}$	39 $\frac{3}{8}$	33 $\frac{3}{4}$
Second Quarter	53 $\frac{1}{2}$	35 $\frac{3}{8}$	37 $\frac{1}{2}$	32 $\frac{3}{8}$
Third Quarter	64 $\frac{3}{4}$	49 $\frac{3}{8}$	34 $\frac{1}{2}$	26 $\frac{1}{4}$
Fourth Quarter	65	36 $\frac{3}{8}$	35 $\frac{3}{8}$	28 $\frac{1}{4}$

In 1987 and 1986, the quarterly dividends were \$.25 per share. As of January 31, 1988, there were approximately 102,000 holders of Santa Fe Southern Pacific common stock.

**To the Stockholders of
Santa Fe Southern Pacific Corporation**

The accompanying financial statements of Santa Fe Southern Pacific Corporation and subsidiary companies were prepared by management, which is responsible for their integrity and objectivity. The statements were prepared in accordance with generally accepted accounting principles and properly include amounts that are based on management's best judgments and estimates. The other financial information included in this annual report is consistent with that in the financial statements.

The Company maintains a system of internal accounting controls, supported by adequate documentation, to provide reasonable assurance that assets are safeguarded and that the books and records reflect the authorized transactions of the Company. Limitations exist in any system of internal accounting controls based upon the recognition that the cost of the system should not exceed the benefits derived. The Company believes its system of internal accounting controls, augmented by its internal auditing function, appropriately balances the cost/benefit relationship.

The independent accountants provide an objective assessment of the degree to which management meets its responsibility for fairness of financial reporting. They regularly evaluate the system of internal accounting controls and perform such tests and other procedures as they deem necessary to express an opinion on the fairness of the financial statements.

The Board of Directors pursues its responsibility for the Company's financial statements through its Audit Committee which is composed solely of directors who are not officers or employees of the Company. The Audit Committee meets regularly with the independent accountants, management and the internal auditors. The independent accountants and the Company's internal auditors have direct access to the Audit Committee, with and without the presence of management representatives, to discuss the scope and results of their audit work and their comments on the adequacy of internal accounting controls and the quality of financial reporting.



Robert D. Krebs
President and Chief Executive Officer



Orval M. Adam
Vice President, Treasurer and Chief Financial Officer

**To the Stockholders, Chairman and
Board of Directors of
Santa Fe Southern Pacific Corporation**

We have examined the consolidated balance sheet of Santa Fe Southern Pacific Corporation and subsidiary companies as of December 31, 1987 and 1986, and the related consolidated statements of income, stockholders' equity, and changes in financial position for each of the three years in the period ended December 31, 1987. Our examinations were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note 3, on January 26, 1988 the Company's Board of Directors declared a dividend of \$30 per share, payable in cash and debentures. The effect of this action is to significantly increase debt and decrease stockholders' equity. In addition, it is anticipated that certain businesses and real estate will be sold with the proceeds used to reduce debt. These events will significantly impact the Company's financial position and results of operations of future periods. The accompanying consolidated financial statements do not reflect these matters because they are events occurring after December 31, 1987.

As discussed in Note 2, the accompanying consolidated financial statements include the assets and operations of the trustee Southern Pacific Transportation Company (SPT). The Interstate Commerce Commission (ICC) has denied Santa Fe Southern Pacific Corporation's (SFSP) application to merge SPT with its other railroad operations (The Atchison, Topeka and Santa Fe Railway Company (ATSF)) and ordered that either SPT or ATSF be divested. SFSP has decided to pursue divestiture of SPT and has entered into a definitive sale agreement. The sale is subject to approval by the ICC and completion of due diligence procedures by the purchaser. If this transaction is not consummated, SFSP will pursue other options to comply with the ICC divestiture order. The accompanying consolidated financial statements do not include any adjustments which may be necessary upon final determination of the portion of SFSP's railroad assets and operations to be divested.

In our opinion, subject to effects on the financial statements of such adjustments as might have been required had the outcome of the matter referred to in the preceding paragraph been known, the financial statements examined by us present fairly the financial position of Santa Fe Southern Pacific Corporation and its subsidiary companies at December 31, 1987 and 1986, and the results of their operations and changes in their financial position for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles consistently applied.



Chicago, Illinois
February 23, 1988

Statement of Income

Santa Fe Southern Pacific Corporation and Subsidiary Companies

Twelve Months Ended December 31

	1987	1986	1985
	(In Millions)		
Revenues			
Natural Resources	\$ 418.7	\$ 329.0	\$ 610.0
Real Estate	450.9	429.7	436.3
Transportation	4,578.8	4,555.7	4,901.5
Total revenues	5,448.4	5,314.4	5,947.8
Operating Expenses			
Natural Resources	335.8	457.0	462.8
Real Estate	131.1	108.0	94.6
Transportation	4,224.3	4,264.3	4,639.8
Rail Restructuring Costs	—	914.1	—
Total operating expenses	4,691.2	5,743.4	5,197.2
Operating Income (Loss)	757.2	(429.0)	750.6
Other Income—Net	3.6	14.8	11.0
Interest Expense	138.6	114.6	120.0
Income (Loss) from Continuing Operations Before Income Taxes	622.2	(528.8)	641.6
Federal Income Tax			
Currently payable	95.3	28.9	5.3
Deferred	125.8	(271.5)	169.1
State Income Tax	55.4	(.9)	28.4
Total income taxes (benefit)	276.5	(243.5)	202.8
Income (Loss) from Continuing Operations	345.7	(285.3)	438.8
Discontinued Operations, Net of Income Taxes	27.8	147.4	30.8
Net Income (Loss)	\$ 373.5	\$ (137.9)	\$ 469.6
Net Income (Loss) Per Share of Common Stock			
Continuing operations	\$ 2.19	\$ (1.73)	\$ 2.50
Discontinued operations	.18	.89	.17
Total	\$ 2.37	\$ (.84)	\$ 2.67
Average Number of Common and Common Equivalent Shares	157.9	165.0	175.6

(See notes to financial statements)

Balance Sheet

Santa Fe Southern Pacific Corporation and Subsidiary Companies

Year Ended December 31

1987

1986

(In Millions)

Assets		
Current Assets		
Cash and temporary investments, at cost which approximates market	\$ 215.6	\$ 580.4
Accounts receivable, less allowances	769.6	820.0
Inventories	175.9	198.9
Other	97.8	151.1
Total current assets	1,258.9	1,750.4
Other Assets	818.4	729.9
Properties, Plant and Equipment	14,829.1	14,208.4
Less—accumulated depreciation, depletion and amortization	5,144.2	5,086.9
Net properties	9,684.9	9,121.5
Total Assets	\$11,762.2	\$11,601.8
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 1,412.2	\$ 1,346.1
Long term debt due within one year	166.2	194.9
Total current liabilities	1,578.4	1,541.0
Long Term Debt Due After One Year	1,704.2	1,726.6
Other Liabilities	701.1	942.8
Deferred Income Taxes	2,518.0	2,298.5
Redeemable Preference Shares of a Subsidiary	52.6	52.6
Stockholders' Equity		
Common stock	190.0	190.0
Paid-in capital	686.2	690.5
Retained income	5,368.2	5,151.5
Unamortized value of restricted stock	(2.9)	(4.3)
Treasury stock, at cost	(1,033.6)	(987.4)
Total stockholders' equity	5,207.9	5,040.3
Total Liabilities and Stockholders' Equity	\$11,762.2	\$11,601.8

(See notes to financial statements)

Statement of Changes in Financial Position

Santa Fe Southern Pacific Corporation and Subsidiary Companies

Twelve Months Ended December 31

1987

1986

1985

(In Millions)

Cash Provided By Operations

Working capital provided by (used for) operations

Income (loss) from continuing operations	\$ 345.7	\$ (285.3)	\$ 438.8
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Items not requiring current use of funds

Depreciation, depletion and amortization	540.0	665.2	559.5
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Deferred income taxes	147.7	(277.9)	184.9
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Equity in undistributed earnings of unconsolidated companies	12.2	19.5	20.0
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Rail restructuring costs	—	865.1	—
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Other—net	6.9	61.3	9.3
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Total from continuing operations	1,052.5	1,047.9	1,212.5
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Income from discontinued operations	27.8	147.4	30.8
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Items not requiring current use of funds

Deferred income taxes	3.2	63.1	3.2
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Other—net	(13.7)	1.4	6.4
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Total from discontinued operations	17.3	211.9	40.4
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Total from operations	1,069.8	1,259.8	1,252.9
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Changes in Working Capital

Accounts receivable	50.4	60.1	(15.2)
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Inventories	23.0	48.2	38.9
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Accounts payable and accrued liabilities	66.1	121.6	(4.0)
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Other current assets/liabilities—net	24.6	(66.7)	21.9
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Total	164.1	163.2	41.6
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Cash provided by operations	1,233.9	1,423.0	1,294.5
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Cash Used For Dividends

(156.8)	(164.9)	(175.1)
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Investment Activities

Capital expenditures	(1,153.7)	(1,061.4)	(1,078.3)
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Property sold or retired	18.6	69.9	54.8
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Note received from sale of discontinued operations	—	(290.0)	—
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Noncurrent assets of subsidiaries sold	(.5)	100.8	—
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Other—net	(234.8)	160.1	(11.3)
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Total investment activities	(1,370.4)	(1,020.6)	(1,034.8)
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Financing Activities

Long term debt incurred	160.0	321.7	142.4
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Reduction in long term debt	(182.4)	(192.7)	(212.8)
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Purchase of treasury stock	(61.9)	(425.8)	(302.1)
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Other—net	12.8	104.1	8.3
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Total financing activities	(71.5)	(192.7)	(364.2)
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Increase (Decrease) in Cash and Temporary Investments

(364.8)	44.8	(279.6)
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Cash and Temporary Investments

Beginning of the year	580.4	535.6	815.2
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End of the year	\$ 215.6	\$ 580.4	\$ 535.6
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(See notes to financial statements)

Statement of Stockholders' Equity

Santa Fe Southern Pacific Corporation and Subsidiary Companies

	Common Stock	Treasury Stock	Common Stock	Treasury Stock	Paid-In Capital	Retained Income	Unamortized Value of Restricted Stock
	(Shares in Thousands)					(Dollars in Millions)	
Balance December 31, 1984	190,094	10,971	\$ 190.1	\$ (274.9)	\$ 694.7	\$5,159.8	\$ (1.2)
1985 net income						469.6	
Dividends declared						(175.1)	
Issuance under Growth Plan		(281)		7.0	.2		(7.2)
Exercise of stock options		(98)		2.8	(1.8)		
Purchase of treasury stock, at cost		9,753		(302.1)			
Other	(70)	16	(.1)	(.3)		.1	2.6
Balance December 31, 1985	190,024	20,361	\$ 190.0	\$ (567.5)	\$ 693.1	\$5,454.4	\$ (5.8)
1986 net loss						(137.9)	
Dividends declared						(164.9)	
Exercise of stock options		(208)		6.7	(2.6)		
Purchase of treasury stock, at cost		12,889		(425.8)			
Other	(1)	31		(.8)		(.1)	1.5
Balance December 31, 1986	190,023	33,073	\$ 190.0	\$ (987.4)	\$ 690.5	\$5,151.5	\$ (4.3)
1987 net income						373.5	
Dividends declared						(156.8)	
Issuance under Growth Plan		(16)		.5	.2		
Exercise of stock options		(546)		16.3	(4.6)		
Purchase of treasury stock, at cost		1,493		(61.9)			
Other		43		(1.1)	.1		1.4
Balance December 31, 1987	190,023	34,047	\$ 190.0	\$ (1,033.6)	\$ 686.2	\$5,368.2	\$ (2.9)

Note: SFSP has authorized common stock of 600 million shares with a par value of \$1.00. Also authorized are 200 million shares of preferred stock with a par value of \$1.00, none of which was outstanding at December 31, 1987.

Note 1: Summary of Significant Accounting Policies*Principles of Consolidation*

The accompanying consolidated financial statements include the accounts of Santa Fe Southern Pacific Corporation ("SFSP") and all entities over 50% owned, directly or indirectly, by SFSP on a consolidated basis except for companies engaged in insurance, financial and leasing services. The proportionate consolidation method is used to account for SFSP's investment in Santa Fe Energy Partners, L. P. Investments in unconsolidated subsidiaries and affiliates and 20% to 50% owned entities are accounted for under the equity method.

Revenue Recognition

Revenues from advance coal royalties are recognized in income in the year received. The revenues and expenses of petroleum trading activities included in petroleum marketing operations are presented on a net basis whereby only the gross margin from such activities is recorded as revenues.

Properties

Properties are stated at cost and include capitalized interest cost incurred during construction applicable to continuing operations of \$33.9 million in 1987, \$39.4 million in 1986 and \$42.9 million in 1985. Additions and replacements are capitalized. Expenditures for maintenance and repairs are charged to income. Upon sale or retirement of units of depreciable railroad and pipeline properties, cost less salvage is charged to accumulated depreciation and no gain or loss is recognized. With respect to all other property units sold or retired, gain or loss is recognized. Property depreciation is based on the estimated service lives of the related assets.

Leasehold Interests and Exploratory Costs

SFSP follows the successful efforts method of accounting for petroleum properties. All costs incurred in acquiring petroleum leasehold interests, consisting primarily of bonus payments, are capitalized. When a lease is proved to be productive, its entire cost is transferred to productive petroleum properties. If a lease proves to be non-productive, the entire cost of the lease is charged against the reserve for unproved leasehold interests. This reserve is provided by amortizing the cost of unproved leasehold interests based on past experience, and adjusted as considered necessary. Geological and geophysical costs, exploratory dry hole costs and annual delay rentals on unexplored leases are charged to income.

Depreciation and Depletion of Productive Petroleum Properties

Productive petroleum properties, consisting principally of tangible and intangible costs incurred in developing a property and costs of productive leasehold interests, are depreciated or depleted on a unit of production method based on annual estimates of remaining proved developed reserves or proved reserves, as appropriate, for each field. Certain other petroleum properties are depreciated on a straight-line basis. Based on continuing evaluations of various factors, impairments (additional depreciation and depletion) are recorded to the extent that the net book value of costs, on a field basis, exceeds the estimated undiscounted future net revenues of proved oil and gas reserves. These impairments aggregated \$3.1 million, \$132.8 million and \$19.7 million in 1987, 1986 and 1985, respectively.

Inventories

Material and supply inventories, which represent approximately 96% of all inventories, are valued at the lower of cost (average or first-in, first-out) or market.

Federal Income Tax

Provisions for federal income tax recognize the tax effects of all transactions entering into the determination of income for financial reporting purposes irrespective of when such transactions are reported for federal income tax purposes. Deferred income taxes are provided to recognize differences in the timing of income and expense for income tax and financial reporting purposes. Investment tax credits have been treated as reductions of income tax expense using the flow-through method.

Note 2: Trusteed Operations

On December 23, 1983 Santa Fe Industries, Inc. ("Santa Fe") and Southern Pacific Company ("Southern Pacific") became wholly owned subsidiaries of SFSP. The business combination was accounted for as a pooling of interests and the results of operations of all prior periods are reported on a combined basis.

The prior approval of the Interstate Commerce Commission ("ICC") was required to combine the railroad and trucking operations of Santa Fe and Southern Pacific under the control of SFSP. To permit consummation of the combination of Santa Fe and Southern Pacific pending ICC review, the common stock of the Southern Pacific Transportation Company ("SPT") was deposited in an independent voting trust. The terms of the voting trust provide that SFSP, Santa Fe and Southern Pacific will not control SPT.

In a decision served October 10, 1986, the ICC denied the application for merger, concluding that the merger would be anti-competitive. SFSP, The Atchison, Topeka and Santa Fe Railway Company ("Santa Fe Railway"), and SPT then sought to reopen the proceeding. On June 30, 1987, the ICC voted to deny these companies' request to reopen the proceeding. The ICC also reinstated its order requiring SFSP to divest SPT or Santa Fe Railway and to submit within 90 days a plan of divestiture including a proposed approach to divestiture and description of assets to be divested, and to file quarterly reports thereafter on the progress of divestiture. SFSP submitted its initial divestiture plan and report on September 4, 1987, indicating that divestiture of SPT would be pursued and outlining various options for accomplishing divestiture.

On December 28, 1987, SFSP announced that it had entered into a definitive agreement (the "SPT Agreement") for the sale of the stock of SPT to Rio Grande Industries, Inc., and one of its wholly owned subsidiaries (together, "Rio Grande") for \$1.02 billion in cash. SPT will retain approximately \$780 million in outstanding debt. The transaction is subject to ICC approval, due diligence and other customary conditions. Under the procedural schedule proposed by the ICC, review of the sale transaction could be completed by late summer, 1988. Rio Grande has until the end of March, 1988, to complete certain additional due diligence to determine if any matter of which it becomes aware during such period could cause the value of SPT to be less than the value assumed by it on the date of the SPT Agreement, and if so, Rio Grande may terminate the SPT Agreement. Because the sale is subject to the approval of the ICC, SPT's results have not been reclassified as discontinued operations nor has the company recorded any loss, which could be significant, relating to the divestiture. If this transaction is not consummated, SFSP will pursue other options available to it. Summary financial information of SPT follows:

Year ended December 31,	1987	1986	1985
(In Millions)			
Operating revenues	\$2,394.9	\$2,361.8	\$2,545.8
Operating expenses	2,304.3	2,959.7	2,529.6
Income (loss) from operations	90.6	(597.9)	16.2
Other income	151.2	165.1	162.3
Interest expense	66.4	67.2	74.3
Income taxes (benefit)	32.4	(246.5)	(13.9)
Net income (loss)	\$ 143.0	\$ (253.5)	\$ 118.1

December 31,	1987	1986
(In Millions)		
Current assets	\$ 566.8	\$ 660.6
Other assets	4,148.7	3,962.0
Total assets	\$4,715.5	\$4,622.6
Current liabilities	\$ 802.5	\$ 731.6
Long term debt	707.2	695.1
Deferred income taxes	609.7	554.0
Other long term liabilities	391.7	580.5
Redeemable preference shares of a subsidiary	52.6	52.6
Stockholder's equity	2,151.8	2,008.8
Total liabilities and stockholder's equity	\$4,715.5	\$4,622.6

Other income of SPT has been reclassified in SFSP's financial statements by business segment.

Note 3: Subsequent Event

On January 26, 1988, the Board of Directors of SFSP declared a dividend distribution of \$25 in cash, plus \$5 principal amount of new senior subordinated debentures for each outstanding share, to be paid in the first quarter of 1988. The cash portion of the dividend amounted to a total cash outflow of approximately \$3.9 billion, which will be primarily financed by a credit agreement which provides for a \$1.76 billion bridge loan facility and a \$1.9 billion reducing revolving loan facility. The bridge loan will be repaid from after tax proceeds received from the sale of non-core assets. The bridge loan must be reduced to \$1.4 billion by June 30, 1988 and terminates on June 30, 1989. The revolving loan facility must be reduced ratably over five years beginning February 16, 1989 through semi-annual payments, and must be terminated no later than February 16, 1994. Additionally, the credit agreement provides for a \$250 million working capital facility which also terminates no later than February 16, 1994. Interest rates under the credit agreement vary depending on options chosen by SFSP as well as certain other factors, but generally are tied to and include premiums over certain reference interest rates (e.g., prime rate).

The senior subordinated debenture portion of the dividend will increase long-term debt by \$782.5 million. These debentures bear interest at 16% and SFSP has the option to pay interest in the form of additional debentures rather than cash until 1994. From 1994 to 2003, when the debentures are due, all interest will be paid in cash. The company is required to redeem 20% of the debentures annually, commencing in 1999.

The following table sets forth the consolidated capitalization of the company and its subsidiaries at December 31, 1987, and the pro forma consolidated capitalization of the company and its subsidiaries after giving effect to the payment of the dividend (assuming 156.5 million shares outstanding); the incurrence of indebtedness under the credit agreement and certain expenses of the restructuring program that are treated as current period expenses (\$15.6 million after tax). The pro forma consolidated capitalization does not reflect sales of businesses or assets intended as part of the company's restructuring program (other than the payment of the dividend).

	Actual	Adjustments	Pro Forma
	(Unaudited, in Millions)		
Existing Long Term Debt, including current portion	\$1,870.4	\$ —	\$1,870.4
Senior Bank Debt A	—	1,760.0	1,760.0
Senior Bank Debt B	—	1,900.0	1,900.0
Senior Subordinated Debentures	—	782.5	782.5
Total Debt	1,870.4	4,442.5	6,312.9
Redeemable Preference Shares of a Subsidiary	52.6	—	52.6
Stockholders' Equity:			
Common Stock	190.0	—	190.0
Paid-in Capital	686.2	—	686.2
Retained Income	5,368.2	(4,710.6)	657.6
Unamortized Value of Restricted Stock	(2.9)	—	(2.9)
Treasury Stock	(1,033.6)	—	(1,033.6)
Total Stockholders' Equity	5,207.9	(4,710.6)	497.3
Total Capitalization	\$7,130.9	\$ (268.1)	\$6,862.8

After the payment of the dividend distribution, future dividends will be limited to \$.10 a share per year.

Note 4: Discontinued Operations

On September 30, 1987, Robert E. McKee, a general building contractor, was sold. Proceeds from the sale totalled approximately \$30.0 million. The sale resulted in a loss of \$1.3 million. On January 15, 1988, Bankers Leasing and Financial Corporation was sold for \$187.5 million. A gain was recorded on the sale in January 1988. On October 9, 1987, the company announced a definitive agreement to sell Santa Fe Pacific Timber Company, which owns approximately 520,000 acres of timberland in northern California, to Sierra Pacific Industries for \$460 million. The sale closed in February, 1988. A gain was recorded on the sale in February, 1988.

On December 22, 1986, SFSP completed the sale of the stock of Kirby Forest Industries, Inc. The sales price was \$315.0 million, payable \$25.0 million in cash and \$290.0 million as a long-term note. Income from discontinued operations is as follows:

	1987	1986	1985
	(In Millions)		
Revenues of discontinued operations	\$301.3	\$487.2	\$490.2
Income from discontinued operations before income taxes	\$ 44.8	\$ 51.0	\$ 42.2
Income taxes	15.7	24.5	11.4
Income from operations	29.1	26.5	30.8
Gain (loss) on sale before income taxes	(3.0)	170.5	—
Income taxes (benefit)	(1.7)	49.6	—
Gain (loss) on sale	(1.3)	120.9	—
Income from discontinued operations	\$ 27.8	\$147.4	\$ 30.8

Note 5: Federal Income Tax

The provision for federal income tax applicable to continuing operations is computed as follows:

	1987	1986	1985
	(In Millions)		
Income (loss) before federal income tax	\$566.8	\$(527.9)	\$613.2
Statutory tax rate	40%	46%	46%
Tax at statutory rate	226.7	(242.8)	282.1
Less reductions for:			
Investment tax credit benefits	—	18.0	66.5
Capital gains	10.8	(28.4)	40.0
Other	(5.2)	10.2	1.2
Total	5.6	(.2)	107.7
Total federal income tax (benefit)	\$221.1	\$(242.6)	\$174.4
Effective tax rate	39.0%	46.0%	28.4%

The provision for deferred federal income tax applicable to continuing operations is comprised of the following tax effects of timing differences:

	1987	1986	1985
	(In Millions)		
Additional depreciation for tax purposes	\$ 99.7	\$ 152.9	\$228.8
Investment tax credits earned under (over) amounts realized	32.3	39.3	(32.7)
Rail restructuring costs	42.2	(420.5)	—
Proved property impairments	(1.2)	(61.3)	(8.8)
Deferred capital gain income	(7.7)	93.7	27.3
Adjustments in accruals not currently deducted for tax purposes	(38.0)	(33.4)	(27.5)
Reclassification of prior year's taxes	—	(21.9)	—
Other	(1.5)	(20.3)	(18.0)
Total deferred federal income tax	\$125.8	\$(271.5)	\$169.1

The federal income tax returns of Santa Fe have been examined through 1983 and Southern Pacific through 1980. All years prior to 1969 are closed to further administrative assessment of tax. Issues relating to the years 1962-1983 are being contested through various stages of administrative appeal or litigation. Management believes adequate provision has been made for any adjustment which might be assessed for years through 1987.

Note 6: Rail Restructuring Costs

During 1986, SFSP reported a \$914.1 million charge related to the restructuring of railroad operations determined independently by Santa Fe Railway and by SPT. Of the total charge, \$312.8 million related to Santa Fe Railway and \$601.3 million to SPT. Santa Fe Railway expected to sell or abandon approximately 3,100 miles of track for a charge of \$103 million, and dispose of approximately 7,900 freight cars and 200 locomotives for a charge of \$44 million. Additionally, it was anticipated that approximately 4,100 employees would be separated or relocated, resulting in a charge of \$166 million. The SPT anticipated selling or abandoning 3,100 miles of track for a charge of \$273 million, and disposing of 9,800 freight cars and nearly 400 locomotives, at a charge of \$120 million. The SPT anticipated that approximately 3,800 employees would be separated or relocated, resulting in a charge of \$208 million. Since establishment in late 1986, \$84.4 million for Santa Fe Railway and \$240.6 million for SPT have been charged against each company's respective restructuring accruals.

Note 7: Master Limited Partnership

In January 1986, SFSP placed substantially all of its domestic oil and gas business and properties other than its significant interests in heavy oil and tertiary recovery operations in Santa Fe Energy Partners, L.P. ("Partnership"), a Delaware limited partnership. Concurrently, 5.75 million units, representing 22% of the total units in the Partnership, were sold to public investors and the balance was retained. Net proceeds of approximately \$106.4 million from the sale were used to retire intercompany debt associated with the properties placed in the Partnership.

During 1987 and 1986, the Partnership paid distributions of \$2.88 per unit. SFSP reinvested its distributions in the Partnership, resulting in the purchase of 3.6 million units in 1987 and 2.9 million units in 1986. SFSP owned 82% of the Partnership at December 31, 1987. The Partnership's properties have estimated reserves of 211.9 billion cubic feet of gas and 29.8 million barrels of oil at December 31, 1987. SFSP's proportionate interest in such reserves is included in reserve disclosures in Note 17.

Note 8: Long Term Debt

Long term debt at December 31, 1987 and 1986 consists of the following:

	1987	1986
	(In Millions)	
Equipment obligations, 7.00% to 15.25%, maturing from 1988 to 2002	\$ 871.9	\$ 929.9
Mortgage bonds, 2.75% to 8.2%, maturing from 1988 to 2001	273.3	279.4
Debentures, 8.35% to 10.35%, maturing from 1988 to 2002	118.9	141.1
Other obligations, 3.75% to 12.63%, maturing from 1988 to 2014	573.1	529.4
Capitalized leases	33.2	41.7
Total long term debt	1,870.4	1,921.5
Due within one year	166.2	194.9
Due after one year	\$1,704.2	\$1,726.6

Projected principal repayments of long term debt, payable as of December 31, 1987, during the five years 1988 through 1992 (excluding capitalized leases) are \$158.8 million, \$200.8 million, \$202.1 million, \$248.4 million, and \$221.8 million, respectively.

Substantially all railroad property is subject to liens securing mortgage bonds or equipment obligations. In addition, certain debt agreements of subsidiary companies include covenants which place limitations on the amount of indebtedness that may be incurred and dividends which may be paid by the related subsidiary companies.

As of December 31, 1987, SFSP had an unused financing facility of \$475.0 million on which it pays a fee of .12%, and SPT had unused bank lines of credit of \$160.0 million on which it pays a fee of .25%. In connection with the restructuring program described in Note 3, the \$475.0 million facility was cancelled in early 1988. See Note 3 for a full description of the impact of the restructuring on the capitalization of SFSP.

Note 9: Leases

SFSP leases certain locomotives, freight cars, trailers, data processing equipment and other property. Future minimum lease payments for capital and operating leases as of December 31, 1987 are summarized as follows:

	Capital Leases	Operating Leases
	(In Millions)	
1988	\$ 90.0	\$ 94.1
1989	8.2	74.5
1990	5.9	61.3
1991	5.4	48.0
1992	5.4	42.2
Later years	12.9	123.0
Total minimum payments	\$ 46.8	\$443.1
Less amount representing interest	13.6	
Present value of minimum lease payments	33.2	
Less current portion	7.4	
Long term portion	\$ 25.8	

Leased assets under capital leases presented in the accompanying balance sheet totaled \$75.6 million with related accumulated amortization of \$53.3 million at December 31, 1987, and \$86.2 million with related accumulated amortization of \$57.3 million at December 31, 1986.

Rental expense for operating leases applicable to continuing operations was \$139.4 million in 1987, \$145.2 million 1986, and \$143.6 million in 1985. Contingent rentals and sublease rentals were not significant.

Note 10: Stock Option and Growth Plans

Under various plans, options have been granted to key employees to purchase common stock of SFSP at a price not less than the fair market value at the date of grant. On April 26, 1983, Santa Fe stockholders approved the Santa Fe 1983 Incentive Stock Option Plan under which options are available for grant until November 30, 1992 covering a maximum of 4,812,000 SFSP shares. This plan was subsequently amended to provide for participation of employees of Southern Pacific and its subsidiaries, and its name was changed to the Santa Fe Southern Pacific 1983 Incentive Stock Option Plan.

On April 23, 1985, SFSP stockholders approved the Santa Fe Southern Pacific Incentive Stock Compensation Plan ("Compensation Plan"). Under this plan SFSP's Board of Directors may grant, to key employees, awards encompassing a maximum of nine million shares of SFSP Common Stock. In accordance with the provisions of this plan such awards may be granted in the form of: (1) options to purchase SFSP's common stock, (2) shares of restricted stock, which may be issued in combination with performance units, and (3) stock appreciation rights. Awards of 1,455,500 shares of SFSP common stock were made in the form of options and stock appreciation rights under the plan, effective January 1, 1987.

Activity in all plans during 1987 and 1986 is summarized below:

	SFSP Shares	Average Price
Options outstanding at December 31, 1985	2,038,793	\$23.61
Exercised	255,850	19.86
Surrendered or terminated	86,611	23.87
Options outstanding at December 31, 1986	1,696,332	\$24.16
Granted	1,455,500	29.75
Exercised	611,144	22.57
Surrendered or terminated	255,716	27.81
Options outstanding at December 31, 1987	2,284,972	\$27.74

Both the number of shares and exercise prices will be adjusted after the payment of the dividend distribution described in Note 3.

During the years 1983, 1985 and 1987, a total of 484,208 shares of SFSP common stock, having a fair market value of \$11.4 million, were awarded as restricted stock under the provisions of Santa Fe's Long Term Earnings Growth and Stock Ownership Plan and the Compensation Plan. Shares granted in 1985 and 1987 are held by SFSP for future distribution to certain officers and key employees in accordance with the restrictive provisions of these plans.

Note 11: Stockholder Rights Plan

On January 28, 1986, SFSP declared a dividend of one preferred stock purchase right for each common share outstanding as of February 13, 1986. Pursuant to the Rights Agreement, as amended, each right may under certain circumstances be exercised to buy one one-hundredth of a newly issued share of Series A Junior Participating Preferred Stock at a price of \$125. The rights may only be exercised after a person or group acquires ownership of 20% or more of SFSP's common shares or commences a tender or exchange offer which upon consummation would result in ownership of 30% or more of the common shares. The rights, which do not have voting rights, expire on February 28, 1996 and may be redeemed by SFSP at a price of \$.05 per right at any time until 15 days, subject to extension, after a public announcement of the acquisition of 20% of SFSP's common stock.

If 20% of SFSP's common stock is acquired by any person or if certain other events occur, then generally, each right not owned by a 20%-or-more stockholder will entitle the holder to purchase, at the right's then-current exercise price, shares of SFSP common stock having a value of twice the right's exercise price. In addition, if SFSP is involved in a merger or other business combination transaction with another person in which its common shares are changed or converted, or sells 50% or more of its assets or earning power, each right (except those held by a 20%-or-more stockholder) will entitle its holder to purchase shares of common stock of the surviving corporation having a value of twice the rights' exercise price.

Note 12: Redeemable Preference Shares of a Subsidiary

The St. Louis Southwestern Railway Company ("SSW"), 99.8 percent owned by SPT, has entered into two agreements providing for the purchase by the Federal Railroad Administration of up to \$53.5 million (\$48.5 million Series A and \$5.0 million Series B) of SSW's non-voting redeemable preference shares.

The Series A shares are subject to mandatory redemption over a 20-year period commencing in 1991, at which time dividends at an annual rate of 4.2% shall be declared and paid over the same period. The agreement also provides for acceleration of redemption payments or conversion into fixed interest debt obligations, under certain events of default.

The Series B shares are subject to mandatory redemption over a 15-year period commencing on the fifth anniversary date of issuance. Dividends at an annual rate of 15.1% shall be declared and paid over a 10-year period commencing on the tenth anniversary date of issuance.

The agreements contain certain restrictions on dividend payments by SSW to its common and preferred shareholders. These dividend payments are restricted to increases in net stockholders' equity, as defined in the agreements. At December 31, 1987, \$48.3 million of Series A and \$4.3 million of Series B redeemable preference shares were outstanding.

Note 13: Pension and Employee Benefit Plans

SFSP and its subsidiaries have a number of pension plans, the most significant of which is the trustee non-contributory Santa Fe Southern Pacific Retirement Plan ("the Plan") which fully complies with ERISA requirements. The Plan covers substantially all officers and employees of SFSP and its subsidiaries not covered by collective bargaining agreements. Benefits payable under the Plan are based on years of service and compensation during the sixty highest paid consecutive months of service during the ten years immediately preceding retirement. SFSP's funding policy is to contribute annually at a rate that matches pension costs accrued, but not less than the ERISA minimum, and not more than the maximum amount deductible for income tax purposes.

During 1986, SFSP adopted the provisions of FASB Statement No. 87, "Employers' Accounting for Pensions." As a result, total pension income, including charges related to other plans, applicable to continuing operations of \$4.5 million was recognized in 1987 compared to income of \$.1 million in 1986 and expense of \$23.5 million in 1985.

The following table sets forth the components of pension income of the Plan for 1987 and 1986.

	1987	1986
	(In Millions)	
Components of pension (income) expense		
Service Cost	\$ 16.4	\$ 13.0
Interest Cost	61.8	60.6
Actual Return on Plan Assets	(203.1)	(175.0)
Net Amortization and Deferral	113.7	94.4
	\$ (11.2)	\$ (7.0)

The Plan's funded status, amounts recognized in SFSP's balance sheet at December 31, 1987 and 1986 and major assumptions used to determine these amounts are shown below. The date used to measure plan assets and liabilities is September 30.

	1987	1986
	(In Millions)	
Plan assets at fair value, primarily invested in common stock, U.S. Bonds and Corporate Bonds	\$932.1	\$766.2
Actuarial present value of projected benefit obligations		
Accumulated benefit obligations		
Vested	(593.7)	(584.4)
Nonvested	(11.7)	(10.4)
Provision for future salary increases	(162.3)	(131.7)
Excess of Plan assets over projected benefit obligations	164.4	39.7
Unrecognized net (gain)/loss from past experience different from that assumed and effects of changes in assumptions	(112.3)	7.0
Unrecognized prior service cost	15.4	—
Unrecognized net asset being recognized over 16 years	(52.2)	(55.9)
Prepaid (accrued) pension cost	\$ 15.3	\$ (9.2)
Major assumptions at year-end		
Discount Rate	8.9%	8.8%
Rate of increase in compensation levels	6.5%	6.5%
Expected long term rate of return on Plan assets	12.5%	12.5%

Despite the severe decline in the equity markets during the fourth quarter, the ratio of plan assets to accumulated vested benefit obligations was approximately 117% at December 31, 1987.

In addition to providing pension benefits, SFSP and its subsidiaries provide health care and life insurance benefits for certain retired employees. The costs of these benefits are recognized as expenses primarily when claims are paid; however actuarially determined accruals are used for some life insurance benefits. Amounts expensed for these plans applicable to continuing operations were \$29.0 million in 1987, \$18.5 million in 1986 and \$27.6 million in 1985.

Note 14: Other Income—Net

Other income-net consists of the following:

	1987	1986	1985
	(In Millions)		
Interest and dividend income	\$ 79.3	\$ 74.3	\$ 75.6
Unallocated corporate expenses	(54.8)	(50.4)	(39.0)
Other—net	(20.9)	(9.1)	(25.6)
Total	\$ 3.6	\$ 14.8	\$ 11.0

Note 15: Contingencies

In December 1981, Texas Utilities Company and its subsidiary, Chaco Energy Company ("Chaco"), brought an action against Santa Fe and others alleging violations of law in connection with a long term coal lease agreement entered into on April 15, 1977 between Chaco and one of Santa Fe's subsidiaries. The complaint alleges that Santa Fe and others fixed the price of coal in the San Juan Basin area of New Mexico, restricted competition in the production and sale of coal from this area, and fraudulently induced Chaco to enter the coal lease agreement. To date Chaco has paid in excess of \$160 million to a subsidiary of Santa Fe pursuant to the terms of the coal lease agreement which obligates Chaco to continue to make payments through the year 2012. The complaint seeks damages in an unspecified amount and to have the coal lease agreement declared void and unenforceable. Santa Fe has denied the allegations and has raised substantial defenses. The case is in discovery.

In January 1986, Santa Fe Railway was added as a defendant in an antitrust lawsuit alleging a conspiracy among railroads to frustrate the construction of a coal slurry pipeline. The plaintiffs claim damages of \$940 million, prior to trebling, and allege that five railroads are jointly and severally liable. Santa Fe Railway has filed pleadings denying all the material allegations of the complaint. On July 31, 1986, a major utility filed a related lawsuit against the same railroads alleging that it would have been a customer of the coal slurry pipeline and lost a contract for lower transportation costs when the pipeline was cancelled. The case is in discovery.

SFSP is also a party to a number of other legal actions arising in the ordinary course of business. While the final outcome of these proceedings including those described above cannot be predicted with certainty, considering the substantial legal defenses available, it is the opinion of SFSP management that none of these actions, when finally resolved, will have a material adverse effect on the consolidated financial position of SFSP.

Note 16: Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities at December 31, 1987 and 1986 consist of the following:

	1987	1986
	(In Millions)	
Drafts payable	\$ 32.0	\$ 20.3
Accounts and wages payable	324.3	347.8
Claim reserves	166.1	156.9
Rail restructuring costs	75.3	21.2
Vacations	132.8	138.7
Interest	37.5	44.9
Federal income tax	43.5	26.2
Taxes, other than federal income tax	182.5	173.3
Other	418.2	416.8
Total	\$1,412.2	\$1,346.1

Note 17: Petroleum Producing Operations

Information relating to oil and gas producing activities is presented in the following schedules. Historical information about proved oil and gas reserve quantities, capitalized costs, costs incurred in and results of operations for petroleum producing activities is presented. The standardized measure of discounted future net cash flows and changes therein are also presented. Certain reserve quantities as well as certain information regarding future production and discounted cash flows were determined by Riggs and Associates, Inc., an independent petroleum consultant.

Reserve Quantities (Unaudited)

Presented are the net proved crude oil and natural gas reserves (all located in the United States) of SFSP's petroleum producing operations and a summary of changes in the quantities of proved reserves during the periods indicated. Reserve quantities cannot be measured exactly. Estimates of reserves require extensive judgments of reservoir engineering data and are generally less precise than other estimates made in connection with financial disclosures. Reserve estimates are reviewed periodically to reflect new geological and geophysical data and changing technological and economic conditions and are subject to revision as additional data becomes available during the producing life of a reservoir.

	1987	1986	1985	1987	1986	1985
	Crude Oil (Million Barrels)			Natural Gas (Billion Cubic Feet)		
Proved reserves:						
Beginning of year	124.4	131.3	135.0	191.6	201.0	192.2
Changes during the year						
Revisions of previous estimates	.5	1.4	(.1)	(3.2)	.1	6.3
Improved recovery	9.0	4.7	4.1	5.2	1.9	5.7
Purchase of reserves in place	19.2	1.5	—	24.6	30.6	.1
Extensions, discoveries and other additions	5.2	7.6	10.5	24.0	14.6	28.5
Change in ownership in Partnership	.5	(4.9)	—	4.5	(34.3)	—
Sales of reserves in place	(.4)	—	—	—	—	—
Production	(19.1)	(17.2)	(18.2)	(29.5)	(22.3)	(31.8)
End of year	139.3	124.4	131.3	217.2	191.6	201.0
Proved developed reserves at end of year	127.1	115.2	121.5	196.2	180.7	193.2

Proved developed reserves at January 1, 1985 were 123.1 million barrels of crude oil and 184.5 billion cubic feet of natural gas.

Capitalized Costs

The following schedule presents total capitalized costs of proved and unproved properties and accumulated depreciation, depletion and amortization related to petroleum producing operations:

As of December 31,	1987	1986
	(In Millions)	
Unproved oil and gas properties	\$ 148.0	\$ 100.9
Proved oil and gas properties	1,522.8	1,288.7
Total capitalized costs	1,670.8	1,389.6
Accumulated depreciation, depletion and amortization	(860.9)	(771.0)
Net capitalized costs	\$ 809.9	\$ 618.6

Costs Incurred

Presented below are costs incurred in petroleum acquisition, exploration and development activities:

For the year	1987	1986	1985
	(In Millions)		
Acquisition of properties			
Proved	\$130.9	\$ 47.1	\$ 2.9
Unproved	57.4	12.2	44.4
Exploration costs	35.0	29.0	57.6
Development costs	80.9	81.9	127.0
Total	\$304.2	\$170.2	\$231.9

The above information includes all costs incurred in each activity, whether capitalized or charged to expense at the time they were incurred. Unproved property acquisition costs for 1987 include \$48.1 million for unproved reserves associated with producing properties acquired in 1987.

Results of Operations for Petroleum Producing Activities

The results of operations for petroleum producing activities, excluding corporate overhead and interest costs, were as follows:

For the year	1987	1986	1985
	(In Millions)		
Revenues	\$325.2	\$255.7	\$506.4
Production costs	128.5	119.5	170.1
Exploration expenses (excluding amortization of unproved leasehold interests)	20.3	20.7	42.9
Depreciation, depletion and amortization	108.5	241.1	148.4
Results before income taxes	67.9	(125.6)	145.0
Income tax expense (benefit)	27.2	(59.1)	60.5
Results of operations for petroleum producing activities (excluding corporate overhead and interests costs)	\$ 40.7	\$ (66.5)	\$ 84.5

Standardized Measure of Discounted Future Net Cash Flows (Unaudited)

Future cash inflows were determined on a property-by-property basis by applying estimated year end prices to the estimated future production of proved reserves. Future production costs were also determined on a property-by-property basis based on estimated year end costs. Future development costs relating to proved undeveloped reserves were based on costs in effect at each respective year end. Future income tax expenses were computed by applying future statutory tax rates to the future pretax net cash flows less the tax basis of the proved properties involved. Future income tax expenses also give effect to permanent differences relating to SFSP's proved oil and gas reserves.

The data should not be construed to represent a forecast of future net cash flows or the current value of proved crude oil and natural gas reserves. Actual future revenues from the production of proved reserves may vary significantly from the estimated future cash inflows due to changes in crude oil and gas prices, and production of the reserves may not occur in the periods assumed. Actual production and development costs will also vary from those estimated due to inflation and other factors. This information is presented primarily as a tool to allow for reasonable comparison of oil and gas reserves through the use of a standardized measurement method. Therefore the data should not be used for other than its intended purpose.

Presented below are future cash flows from estimated production of proved crude oil and natural gas reserves, discounted at 10% as required by Financial Accounting Standards Board Statement No. 69.

For the year ended December 31,	1987	1986	1985
	(In Millions)		
Future cash inflows	\$2,174.2	\$1,581.4	\$3,362.9
Future production costs	1,030.3	696.2	1,458.3
Future development costs	23.6	20.2	21.1
Future income tax expense	276.5	222.1	749.8
Future net cash flows	843.8	642.9	1,133.7
10% annual discount for estimated timing of cash flows	293.1	232.4	408.9
Standardized measure of discounted future net cash flows	\$ 550.7	\$ 410.5	\$ 724.8

The following table summarizes the principal sources of change in the standardized measure of discounted future net cash flows:

	1987	1986	1985
	(In Millions)		
Beginning of year	\$410.5	\$724.8	\$775.5
Sales of oil and gas produced, net of production costs	(196.7)	(136.2)	(336.3)
Net changes in prices and production costs	69.0	(541.3)	(141.0)
Changes in estimated future development costs	(12.4)	(33.3)	(21.4)
Extensions, discoveries, and improved recovery, less related cost	81.2	47.6	179.2
Previously estimated development costs incurred during the period	9.0	34.2	46.6
Revisions of previous quantity estimates	.1	4.7	(4.7)
Purchase of reserves in place	111.9	29.3	.3
Accretion of discount	55.2	120.3	130.0
Net change in income taxes	(38.6)	336.6	50.4
Change in ownership in Partnership	6.0	(87.6)	-
Other	55.5	(88.6)	46.2
End of year	\$550.7	\$410.5	\$724.8

Note 18: Information on Business Segments

Revenues and operating income for each business segment are shown on page 13. Intersegment sales are not significant and no one customer accounts for 10% or more of consolidated revenues.

Identifiable assets and properties, plant and equipment at December 31, 1987, 1986 and 1985 and capital expenditures and depreciation, depletion and amortization expenses for the three years then ended are as follows:

	1987	1986	1985
	(In Millions)		
Identifiable assets			
Natural Resources	\$ 1,057.5	\$ 851.6	\$ 1,088.8
Real Estate	721.5	640.1	614.0
Transportation	9,173.2	8,952.1	9,022.9
Corporate	636.6	902.9	630.9
Continuing operations	11,588.8	11,346.7	11,356.6
Discontinued operations	161.6	234.0	381.6
Total	11,750.4	11,580.7	11,738.2
Investment in unconsolidated subsidiaries and other affiliated companies	11.8	21.1	69.4
Total assets	\$11,762.2	\$11,601.8	\$11,807.6
Properties, plant and equipment			
Natural Resources	\$ 1,791.9	\$ 1,502.5	\$ 1,568.1
Real Estate	814.7	733.9	602.5
Transportation	12,168.6	11,917.6	11,782.9
Corporate	25.4	20.3	21.7
Continuing operations	14,800.6	14,174.3	13,975.2
Discontinued operations	28.5	34.1	246.6
Total	\$14,829.1	\$14,208.4	\$14,221.8
Capital expenditures			
Natural Resources	\$ 293.1	\$ 160.9	\$ 202.2
Real Estate	134.7	159.9	84.4
Transportation	721.5	728.4	779.0
Corporate	1.3	2.3	.6
Continuing operations	1,150.6	1,051.5	1,066.2
Discontinued operations	3.1	9.9	12.1
Total	\$ 1,153.7	\$ 1,061.4	\$ 1,078.3
Depreciation, depletion and amortization expense			
Natural Resources	\$ 118.7	\$ 247.4	\$ 155.3
Real Estate	9.8	7.6	5.2
Transportation	409.3	408.4	396.8
Corporate	2.2	1.8	2.2
Continuing operations	540.0	665.2	559.5
Discontinued operations	(.6)	9.3	9.6
Total	\$ 539.4	\$ 674.5	\$ 569.1
Amortization of capital leases included above	\$ 5.2	\$ 5.5	\$ 6.9

Note 19: Summarized Quarterly Operating Results (Unaudited)

	1987				1986			
	First	Second	Third	Fourth	First	Second	Third	Fourth
	(In Millions)							
Revenues	\$1,249.6	\$1,327.9	\$1,380.7	\$1,490.2	\$1,324.4	\$1,284.3	\$1,285.2	\$1,420.5
Operating Income (Loss)	\$ 105.1	\$ 179.7	\$ 213.1	\$ 259.3	\$ 72.4	\$ 120.8	\$ 19.9	\$ (642.1)
Net Income (Loss)								
Continuing operations	\$ 43.5	\$ 80.5	\$ 115.0	\$ 106.7	\$ 27.1	\$ 70.5	\$ (.4)	\$ (382.5)
Discontinued operations	2.4	9.9	8.5	7.0	2.6	11.3	12.8	120.7
Total	\$ 45.9	\$ 90.4	\$ 123.5	\$ 113.7	\$ 29.7	\$ 81.8	\$ 12.4	\$ (261.8)
Net Income (Loss) Per Share								
Continuing operations	\$.28	\$.51	\$.72	\$.68	\$.16	\$.42	\$ —	\$ (2.40)
Discontinued operations	.02	.06	.06	.04	.01	.07	.08	.76
Total	\$.30	\$.57	\$.78	\$.72	\$.17	\$.49	\$.08	\$ (1.64)

(1) Third quarter of 1986 was adversely affected by impairments on proved petroleum properties of \$130.6 million.

(2) Fourth quarter of 1986 was adversely affected by the recording of rail restructuring costs of \$914.1 million.

(3) The sum of net income (loss) per share for the four quarters of 1986 does not equal net loss per share for the full year due to the effects of treasury stock purchases.

Note 20: Coal Reserves (Unaudited)

Coal reserves are as follows:

As of December 31:	1987	1986	1985	1984	1983
Proved and probable coal reserves (million tons)					
Leased to others	490	490	494	483	485
Unleased	230	273	274	277	273
Total	720	763	768	760	758
Average price received (per ton)					
Royalty	\$ 5.92	\$ 4.74	\$ 3.87	\$ 3.90	\$ 4.22
Production	\$24.01	\$25.95	\$27.91	\$24.73	—
Tons produced (in thousands)	1,973	1,526	2,159	241	—

Directors

Corporate Officers

Joseph F. Alibrandi *
Chairman and Chief Executive Officer
Whittaker Corporation
(a diversified manufacturer
and distributor)
Los Angeles, California

Benjamin F. Biaggini ••
Retired Chairman and
Chief Executive Officer,
Southern Pacific Company
San Francisco, California

Marshall A. Cohen
President
Olympia & York
Enterprises Corporation
(real estate, natural resources and
financial services)
Toronto, Ontario, Canada

Richard J. Flamson III •
Chairman and Chief Executive Officer
Security Pacific Corporation and
Chairman
Security Pacific National Bank
Los Angeles, California

Robert E. Gilmore ••
Retired President and
Chief Operating Officer
Caterpillar Tractor Co.
(manufacturer of earthmoving,
construction and materials handling
machinery and equipment)
Peoria, Illinois

Robert D. Krebs •••
President and
Chief Executive Officer
Santa Fe Southern Pacific Corporation
Chicago, Illinois

Arjay Miller ••
Director of various corporations,
Dean Emeritus, Graduate School of
Business, Stanford University
Woodside, California

Michael A. Morphy ••
President
MorMarketing, Inc.
(marketing of employee benefit concepts)
Pasadena, California

George B. Munroe •
Chairman of the Finance Committee
Phelps Dodge Corporation
(producer of copper and other metals
and manufacturer of copper products)
New York, New York

Jack S. Parker ••
Rancher, Retired Vice Chairman,
Director and Executive Officer
General Electric Company
Fairfield, Connecticut

John S. Reed ••
Chairman
Santa Fe Southern Pacific Corporation
Chicago, Illinois

Paul Reichmann
Senior Executive Vice President
Olympia & York
Developments Limited
(real estate, natural resources and
financial services)
Toronto, Ontario, Canada

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Owner and Operator
Runnells-Pierce Ranch
Bay City, Texas

Jean Head Sisco ••
Partner, Sisco Associates
(management consultants)
Washington, D.C.

W. John Swartz •
Vice Chairman
Santa Fe Southern Pacific
Corporation and
President
Santa Fe Industries, Inc. and
President
The Atchison, Topeka and
Santa Fe Railway Company
Chicago, Illinois

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Advisory Director
Shearson, Lehman Hutton
(investment banker and broker-dealer)
Chicago, Illinois

Robert H. West ••
Chairman
Butler Manufacturing Company, Inc.
(manufacturer of prefabricated
buildings and storage facilities)
Kansas City, Missouri

Arthur W. Woelfle ••
Retired Chairman
Kraft, Inc.
(producer of processed packaged foods)
Glenview, Illinois

Kathryn D. Wriston ••
Director of various corporations
New York, New York

John S. Reed
Chairman

Robert D. Krebs
President and Chief Executive Officer

W. John Swartz
Vice Chairman

Orval M. Adam
Vice President, Treasurer and
Chief Financial Officer

William R. Denton
Vice President and
Chief Administrative Officer

Jerome F. Donohoe
Vice President—Law

Frank N. Grossman
Vice President—
Corporate Communications

Thomas I. McKnew, Jr.
Vice President, Washington, D.C.

Fred C. Schulte
Vice President—Executive Department

Jerome F. Kever
Controller

Richard B. Bonneville
Secretary

- Executive Committee
- * Compensation and Benefits
Committee
- Audit Committee
- ◆ Nominating Committee
- Pension Committee

Corporate Information

Principal Subsidiary Companies

Transportation Group

The Atchison, Topeka and Santa Fe Railway Company

Southern Pacific Transportation Company
St. Louis Southwestern Railway Company

Santa Fe Pacific Pipelines, Inc.
Southern Pacific Pipe Lines, Inc.
San Diego Pipeline Company

Pacific Motor Trucking Company

Real Estate Group

Santa Fe Pacific Realty Corporation
Southern Pacific Land Company
Santa Fe Land Improvement Company
Southern Pacific Development Company
Southern Pacific Industrial Development Company

Natural Resources Group

Santa Fe Energy Company
Santa Fe Energy Products Company

Santa Fe Pacific Minerals Corporation
Santa Fe Pacific Mining, Inc.
Santa Fe Pacific Coal Corporation

Annual Meeting

The annual meeting of stockholders will be held in the Regency Ballroom of the Ramada Inn—Downtown, 420 East Sixth Street, Topeka, Kansas on Tuesday, May 24, 1988 at 10:00 A.M.

Shares Listed

New York Stock Exchange
Midwest Stock Exchange
Pacific Stock Exchange
Ticker Symbol: SFX

Corporate Office

224 South Michigan Avenue
Chicago, Illinois 60604
(312) 786-6000

Registrar of Stock

Morgan Shareholder
Services Trust Company
30 West Broadway
New York 10007

Transfer Agent

D.J. Klippel
Santa Fe Southern Pacific
Corporation
120 Broadway
New York 10271
(212) 962-3111

Dividend Reinvestment

Santa Fe Southern Pacific Corporation provides an automatic dividend reinvestment service to stockholders as a convenient method of investing Company dividends. If you would like a booklet describing this service, please write the Transfer Agent.

Form 10-K and Fact Book

To receive without charge a copy of the Company's Form 10-K annual report to the Securities and Exchange Commission and the Company Fact Book containing financial and statistical information write:

Richard B. Bonneville
Secretary
Santa Fe Southern Pacific
Corporation
224 South Michigan Avenue
Chicago, Illinois 60604

Santa Fe Southern Pacific Corporation
224 South Michigan Avenue
Chicago, Illinois 60604